MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 25 May 2020

Key Themes

Consumer sentiment in the US barely improved in May despite most states now starting to lift stay-at-home restrictions. Consumer assessment of current conditions improved, while expectations of future conditions actually continued to worsen.

The small improvement in current conditions was likely due, in part, to the receipt of stimulus payments and the start of unemployment insurance payments. The headline +10.5% growth in personal income in Apr hides the underlying performance issues – that over the last two months, US wages and salaries income has declined by over US$1 trillion. The income growth in Apr came from government transfer payments – mostly the CARES ACT payments. The CARES ACT payments are only a one-time payment. The reality is that for many people, that payment will need to cover the period of time until they can get back to work. The expectation of weaker future conditions is one driver of the larger fall in consumption expenditure (across both goods and services) and the subsequent significant increase in the savings rate this month.

As for recoveries, another 2 million+ people in the US filed an initial unemployment claim last week. The ten-week total of initial unemployment claims has now reached 40 million people.

The first US regional surveys for May show some improvement in manufacturing conditions. Most measures indicate that the pace of decline has eased from the shutdown in Apr. But the proportion of firms reporting *further weaker conditions in May* still outnumber those starting to see improvements. Outlooks remain pessimistic.

The advance durable goods report revealed severe declines in Apr for orders and shipments. This was the worst monthly decline in shipments by a large margin. The main drivers of the falls were transport – led by motor vehicles and non-defense aircraft. Orders for non-defense aircraft were again cancelled this month and the value of shipments in Apr fell to a mere $4.4bn which is now 70% below the peak reached in Nov 2018. Most other sectors also recorded declines in orders and shipments.

Outside of the US, Japanese industrial production data confirmed the scale of the decline in manufacturing activity in Apr as telegraphed by the weaker PMI's. The declines in production and shipments have been led mostly by larger falls in transport equipment manufacturing.

Germany Q1 GDP decline of -2.2% was confirmed in the second estimate. This is the second consecutive quarter of GDP decline for Germany.

Contents

US Data

Initial and Continuing Jobless Claims wk ending 22 May

There was a further +2 million people filing an initial unemployment claim in the US last week. This is still an extraordinarily high number of people filing new claims. The total number of new claims over the last ten (10) weeks has now exceeded forty (40) million new claims.

Continuing claims now nine (9) weeks in, has remained around 21 million, falling back slightly from the 24 million insured claims from early May.

Advance Initial Claims wk ending 23 May 2020; 2,123,000 people

Advance claims from the week prior were revised slightly higher to 2,446,000 claims (+8k).

The number of continuing claims was lower;

Advance Claims for Insured Unemployment at wk ending 16 May 2020; 21,052,000

This was 3,860,000 LESS continuing claims than registered in the week ending 9 May. Maybe this is peaking? The insured unemployment rate fell from 17.1% to 14.5% in the week ending 16 May.

https://www.dol.gov/ui/data.pdf

University of Michigan Consumer Sentiment Final (May)

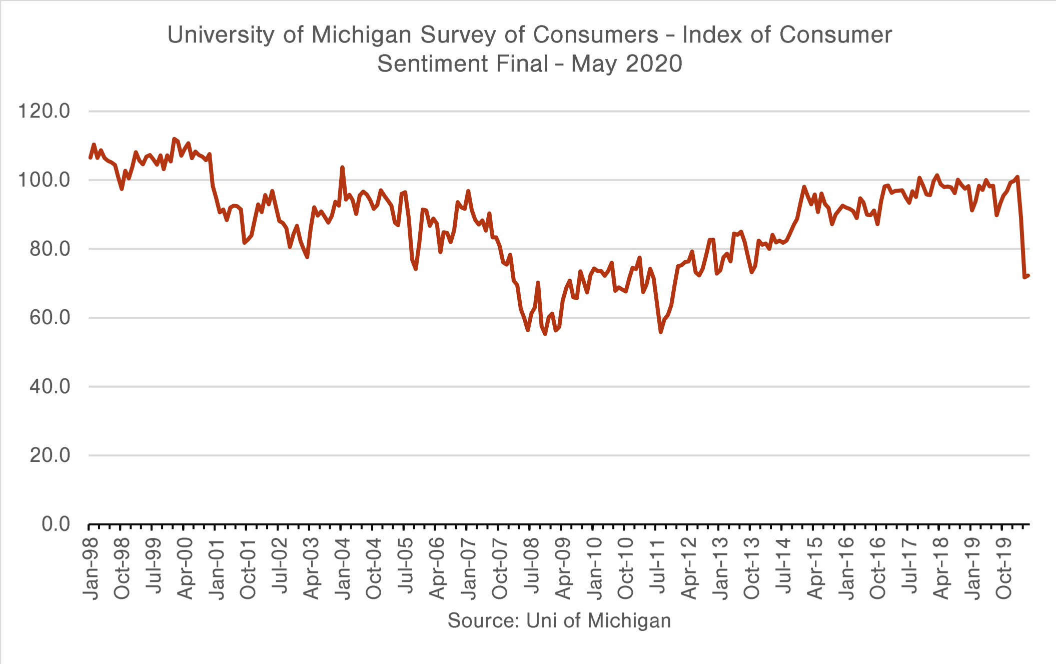
The headline measures of consumer sentiment were revised slightly lower in the final release of the report for May. Sentiment does not seem to be responding to the lifting of restrictions.

Headline consumer sentiment was little changed and remained close to recent low levels. Most consumers expect that conditions will remain challenging over the coming year. Current conditions have been buoyed somewhat by stimulus checks and unemployment insurance. This has not stimulated discretionary spending due to uncertainty over the pandemic.

Consumer Sentiment Index – month; May 72.3 versus Apr 71.8

Overall sentiment was little changed from the month prior – despite the widespread lifting of state restrictions throughout the month. Uncertainty around the pandemic remains high;

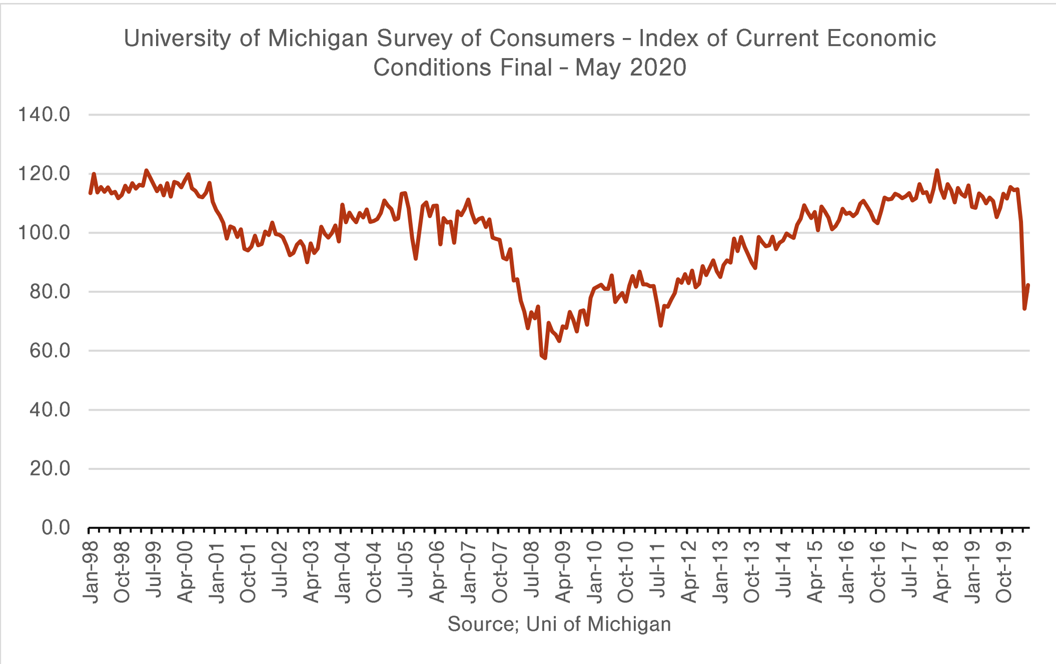
> The CARES relief checks and higher unemployment payments have helped to stem economic hardship, but those programs have not acted to stimulate discretionary spending due to uncertainty about the future course of the pandemic



<u>Sentiment of Current Conditions Index – month</u>; May 82.3 versus Apr 71.8

The current conditions index made a somewhat larger rebound this month after the historic fall in the two months prior. But while stimulus checks have helped to bridge the income loss, future expectations continue to weigh on spending. The CARES Act checks are a one-time payment, not an ongoing source of income.

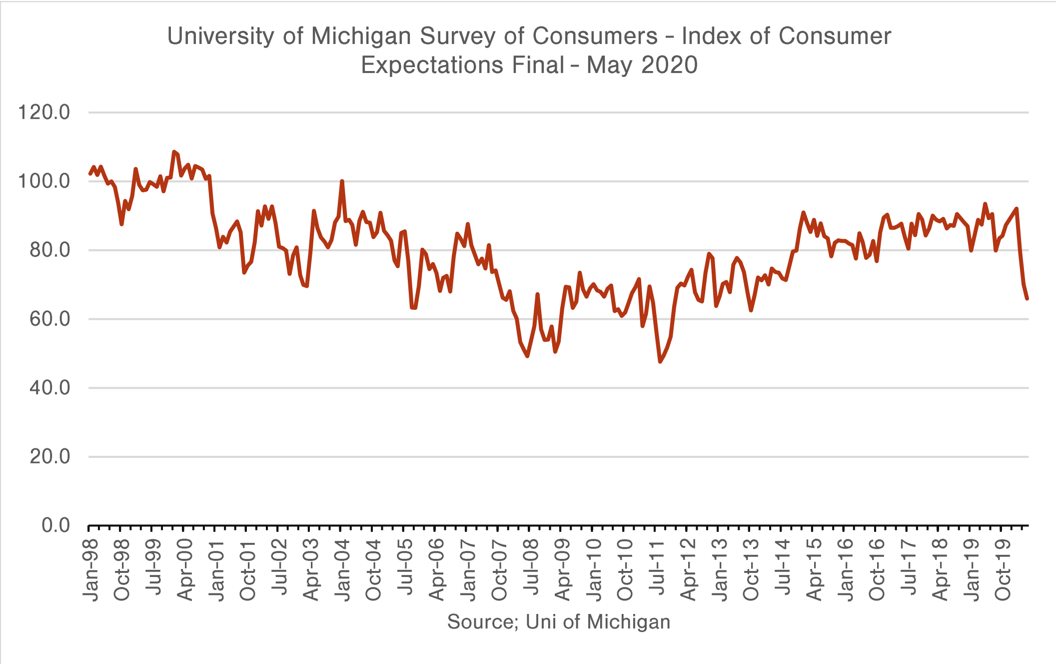
More widespread price discounting as well as low interest rates have helped to improve buying plans, but those plans still remain well below the levels recorded three months ago.



Index of Consumer Expectations of Conditions – month; May 65.9 versus Apr 70.1

Expectations for the year ahead deteriorated further this month – despite the lifting of restrictions and fiscal support.

> Adding to consumers' concerns about a significant expected drop in income growth, year-ahead inflation expectations rose sharply, putting extra pressure on consumers' abilities to maintain their living standards.



http://www.sca.isr.umich.edu/

Personal Income **and Consumption Expenditure – Monthly (Apr)**

Total disposable income significantly increased this month. This was the result of a larger fall in employee compensation which was offset by 1) increased unemployed insurance and 2), mostly reflected the delivery of one-time CARES ACT payments.

Expenditures declined further in Apr – likely the result of uncertainty around the pandemic, uncertainty regarding future employment and income and/or reduced opportunity due to spend due to stay at home orders.

The pace of saving increased significantly. Most of the stimulus/increase in income this month was via the one-time payment – which for many people will need to supplement unemployment insurance until stay at home orders are removed and businesses restart.

These restrictions are now mostly starting to lift as of the end of May, so data for May regarding employment, income and expenditure will provide some insight as to how quickly business is rebounding.

All values are USD and are quoted at seasonally adjusted annual rates (SAAR).

PERSONAL INCOME

There was a significant increase in personal income and personal income growth this month. The severe declines in employee compensation over the last two months were more than offset by government transfer payments via the CARES Act as well as an increase in unemployment insurance this month. The CARES Act payments are a one-time payment though.

Personal Income – month change; Apr +10.5% (+$1,695bn) versus Mar -2.2%

The largest proportion of personal income is compensation of employees and in Apr this declined by 7.7% or -$878bn. This is on top of the 3.2% decline recorded in Mar or -$374.6bn.

Also declining this month was proprietor's income (-12.2%) and personal income receipts on assets (-1.5%).

This month, that was offset by an almost doubling of Personal Current Transfers; Apr +89.6% (+$2,999bn) versus Mar +2.1% (+$70.4bn)

This was made up of;

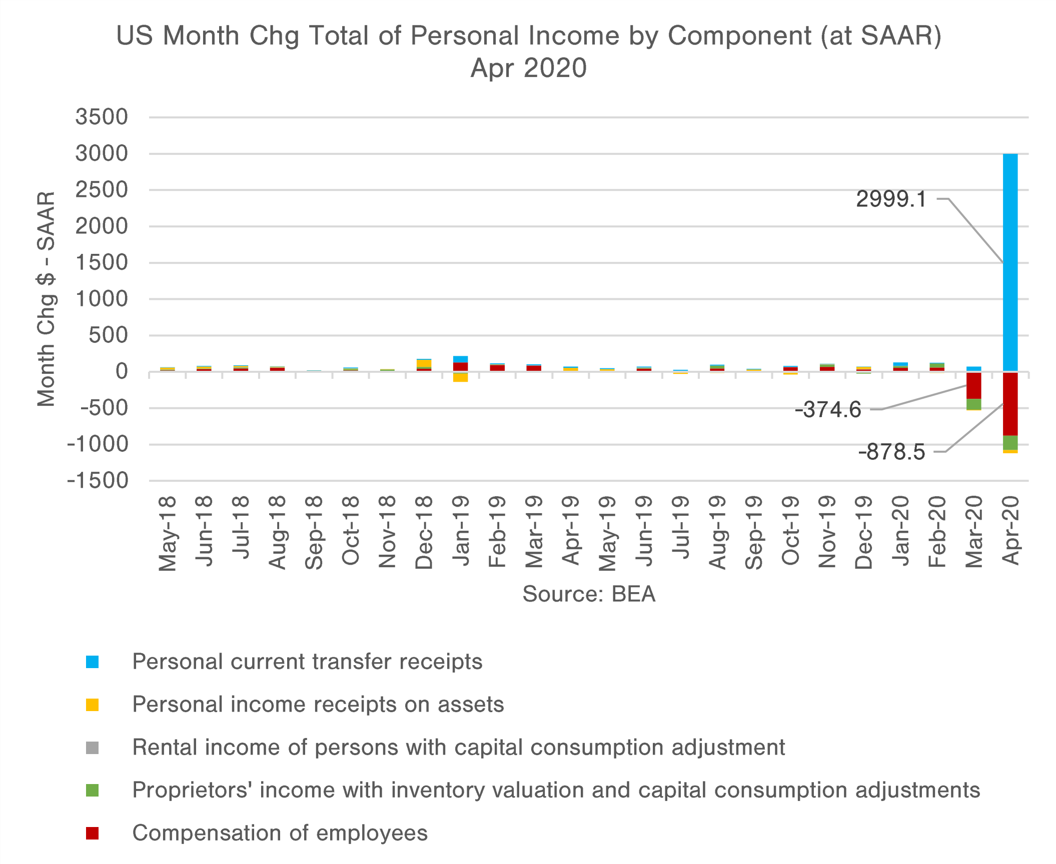
Unemployment insurance; Apr +518% (+$360bn) versus Mar +165% (+$43.4bn). This is important to watch carefully in the future. Timing lags on benefits are likely impacting the results so far, but the decline in wages and salaries in Apr (-$780bn) were not offset by increases in unemployment insurance payments of +$360bn in Apr.

The one-time CARES Act payments via 'other transfer payments' ; Apr +491% (+$2,593.8bn) versus Mar +0.1% (+$0.7bn). The CARES Act payment is one-time – so for many people will need cover the time until stay at home orders are removed and business start hiring again.

Personal current taxes declined by -7.4% (-$161.8bn)

Personal Disposable Income - transfer payments helped to off-set the decline in compensation resulting in a +12.9% increase in Personal Disposable Income (+$2,127bn versus the month prior). Consumers mostly saved this increase in personal disposable income.

The chart below provides the scale of the impact this month with the growth ($ val at SAAR's) in transfers (mostly CARES ACT one-time payments) versus the decline in employee compensation.



<u>PERSONAL OUTLAYS</u>

Despite the growth in income, personal outlays in Apr continued to decline. Uncertainty around the pandemic, uncertainty regarding future employment and income and reduced opportunity to spend all likely played a role in the result.

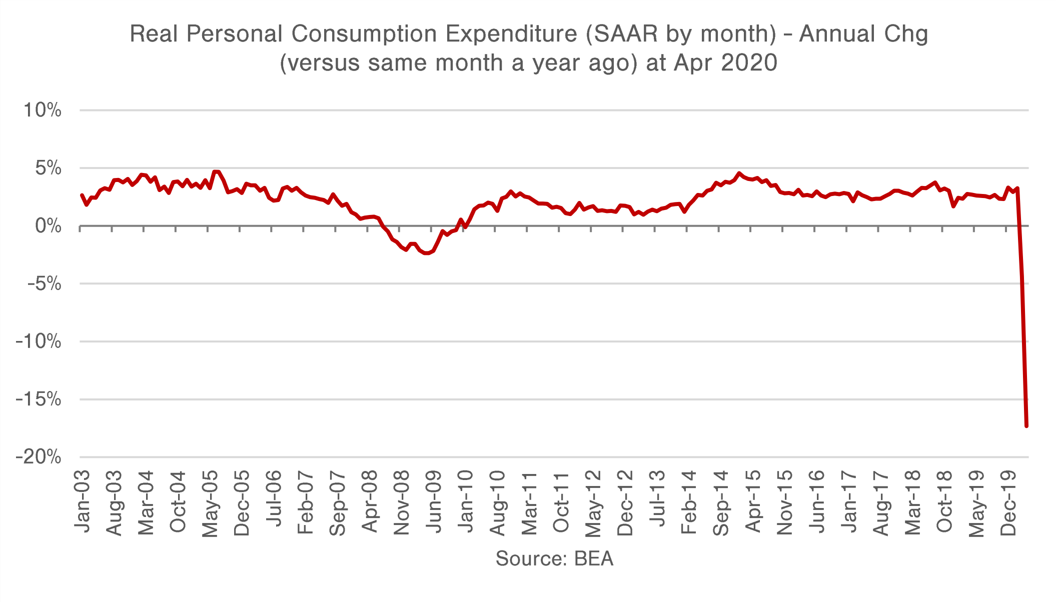
<u>Personal Consumption Expenditures – month change</u>; Apr -13.6% (-$1,893bn) versus Mar -7% (-$1,031bn)

Consumption expenditure declined across durable goods (-17.3%), non-durable goods (-16.2%) and services (-12.2%) versus the month prior.

> Within goods, decreases in all subcomponents were led by a decrease in food and beverages. Within services, the largest contributors to the decrease were spending for health care as well as food services and accommodations.

In real terms, the Apr 2020 personal consumption expenditure fell to levels not recorded since Dec 2011.

In real terms, personal consumption declined by -17% in Apr versus the same month a year ago;



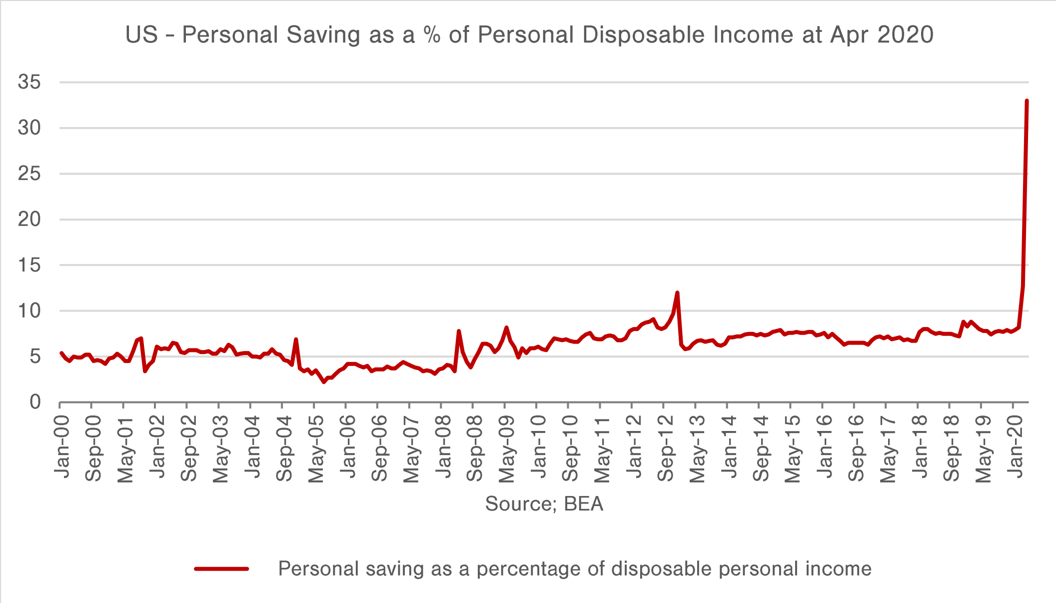
<u>PERSONAL SAVING</u>

Last month, there was a large fall in personal disposable income and an even larger decline in personal consumption expenditures – this resulted in a relatively large increase in personal saving as a % of disposable personal income – that value was +$716bn.

This month, there was a much larger increase in disposable income, yet personal consumption expenditures still declined by a larger value than in the month prior. As a result, savings increased by +$4,041bn (or $4 trillion). This is calculated as the surplus from personal disposable income less, personal outlays.

As mentioned, there are several possible reasons for the lower consumption/higher saving; uncertainty around the pandemic, uncertainty regarding future employment and income and reduced opportunity due to spend stay at home orders.

The proportion of personal saving as a % of Personal Disposable Income increased notably from an already elevated 12.7% in Mar to 33% in Apr.



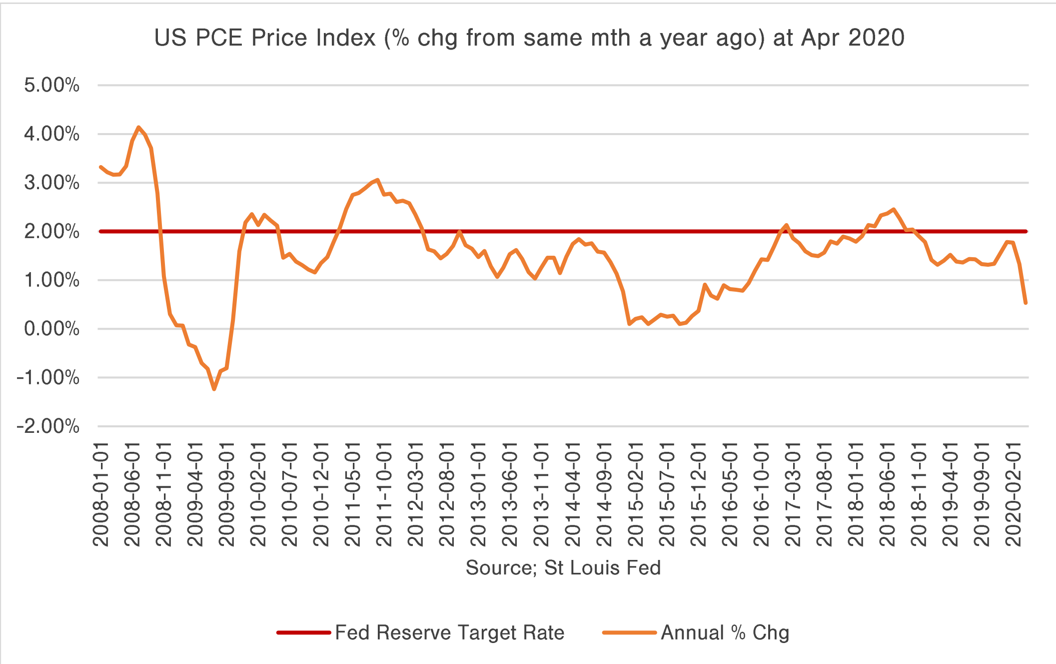
https://www.bea.gov/data/income-saving/personal-income#:~:text=What%20is%20Personal%20Income%3F,health%20and%20future%20consumer%20spending.

Personal Consumption Expenditure Price Index – Monthly (APR)

The PCE price index decelerated notably in Apr, on both a monthly and annual basis. While energy and gasoline prices declined notably in the month this offset much higher growth in food at home prices. But core PCE prices also grew at a slower pace this month.

Headline PCE Price Index – annual change; Apr +0.54% versus Mar +1.33%

Most areas contributed to the slow down in price growth this month.



Durable goods prices declined by -0.7% in Apr and by -2.2% on an annual basis.

Non-durable goods prices also declined at an accelerated annual pace of -1.7%. Within this group though, food price growth accelerated while energy prices fell.

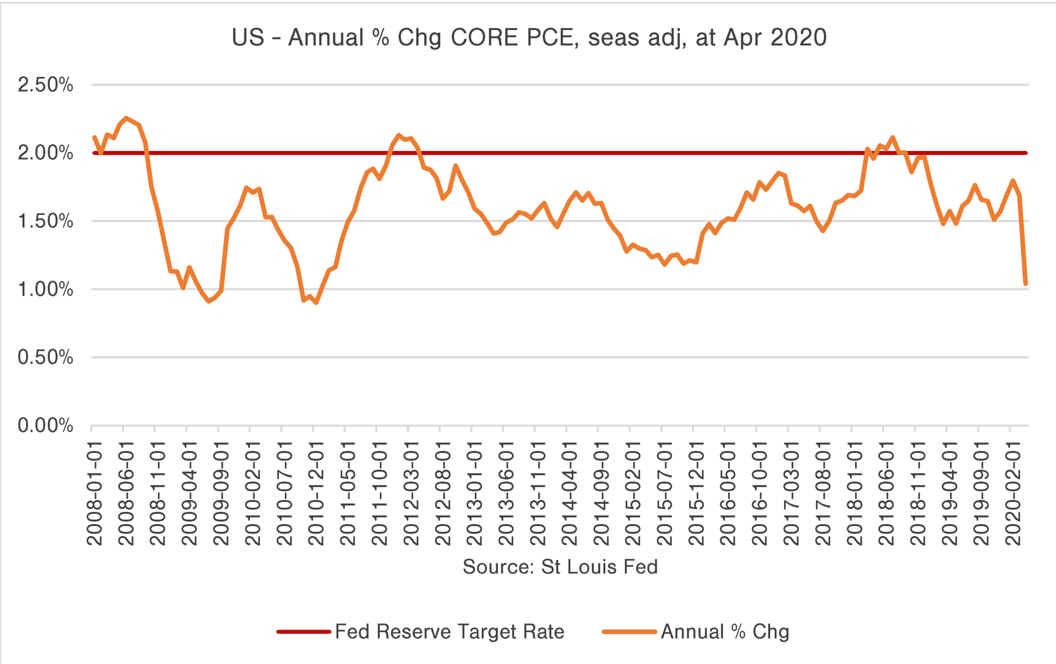
Food for off-premise consumption increased by +2.6% in the month and by 4% versus a year ago.

Gasoline and energy goods prices declined by 20% in the month and were -30% below the same month a year ago.

Services prices also contributed to the slower growth this month, with growth slowing from +2.4% in Mar to +1.7% in Apr. Services prices declined by -0.3% in the month as well – which is rare.

Core PCE Price Indexes Ex food and energy prices – annual change; Apr +1.04% versus Mar +1.69%.

So even excluding the impact of gasoline and energy price falls, core PCE still declined on a monthly basis too, falling by -0.4%. Both core goods and core services prices both declined in the month by -0.6% and -0.3% respectively.



https://fred.stlouisfed.org/series/PCEPILFE#0

https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=2&isuri=1&1921=underlying

Advance Report on Durable Goods Orders (Apr)

This report provides further detail and confirmation of the size and level of the decline in US manufacturing in Apr.

The PMI's in Apr indicated that new orders and shipments both declined at an accelerated pace – probably one of the steepest declines recorded so far in those data series. Those series record higher, lower or no change, so instead reflect the proportion of firms reporting changes.

The advance durable goods data this month reveals quite severe declines in Apr for orders and shipments. This was the worst monthly decline in shipments by a large margin. The main drivers of the falls were transport – led by motor vehicles and non-defense aircraft. Orders for non-defense aircraft were again cancelled this month and the value of shipments in Apr fell to a mere $4.4bn which is now 70% below the peak reached in Nov 2018. Most other sectors also recorded declines in orders and shipments this month. Computers and electronic products were the best performer this month.

<u>NEW ORDERS</u>

<u>New Orders – month change</u>; Apr -17.2% (-$35.4bn) versus Mar -16.6% (-$40.8bn)

This is the second consecutive month of significant declines in new orders. The largest monthly decline going back to Mar 1992 was in Aug 2014 (-18.8% decline in new durable goods orders). Even during the GFC the largest month decline was -10.7% - but this was during a sixteen (16) month period of consecutive monthly declines.

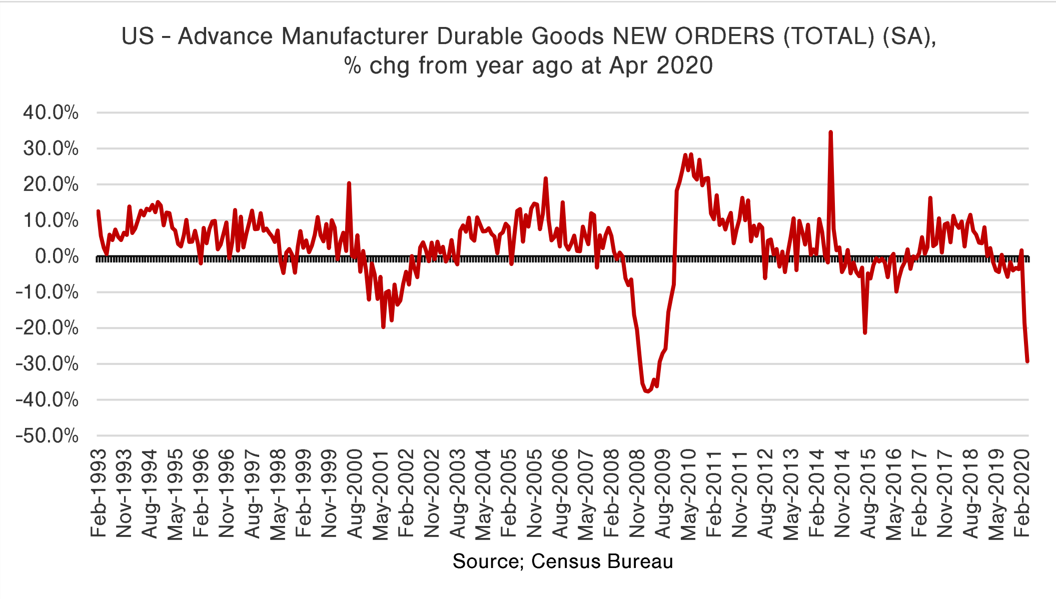
In Apr 2020, declines in new orders were recorded across most durable goods sectors. The worst sector was again non-defense aircraft which recorded another decline of -$8.5bn in orders – note that this is not the month change, but the month total. This likely reflects cancelled orders.

Total transportation equipment orders declined by 47% (-$23.8bn) in Apr versus Mar.

Excluding transportation equipment, the monthly decline in durable goods orders was -7.4%. This is still above the worst month of the GFC which was Jan 09 when orders ex transports declined by -10.3%.

The "best" performing sector was computers and electronic products – orders declined by only -0.3%.

<u>On an annual basis</u>, total durable goods orders in Apr 2020 were -29% below the same month a year ago. This annual pace of decline is still above that of during the GFC.



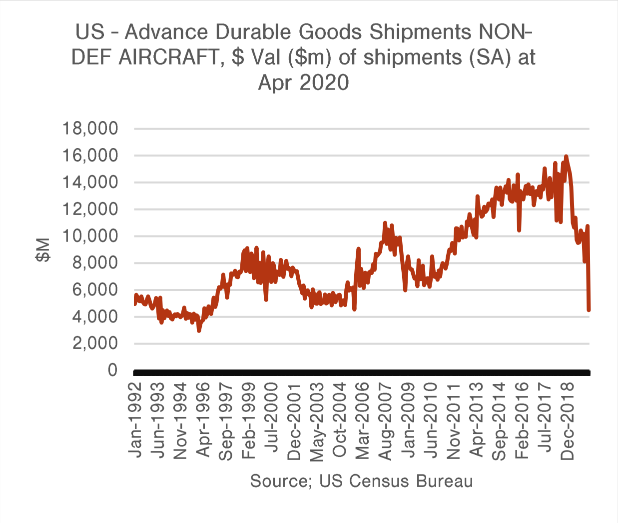
Excluding transportation equipment, orders declined by -9.3% versus a year ago.

SHIPMENTS

Advance Durable Goods Shipments – month change; Apr -17.7% (-$41.5bn) versus Mar -5.5% (-$13.8bn)

This was the single worst monthly decline in durable goods shipments going back to Mar 1992. The second worst period was during the GFC, when shipments declined by -6.9% in Jan 2009.

The worst performing sector was transportation equipment recording a 42% decline in shipments versus the month prior (-$31.4bn versus Mar). Motor vehicles were the bulk of the decline (-$25bn).

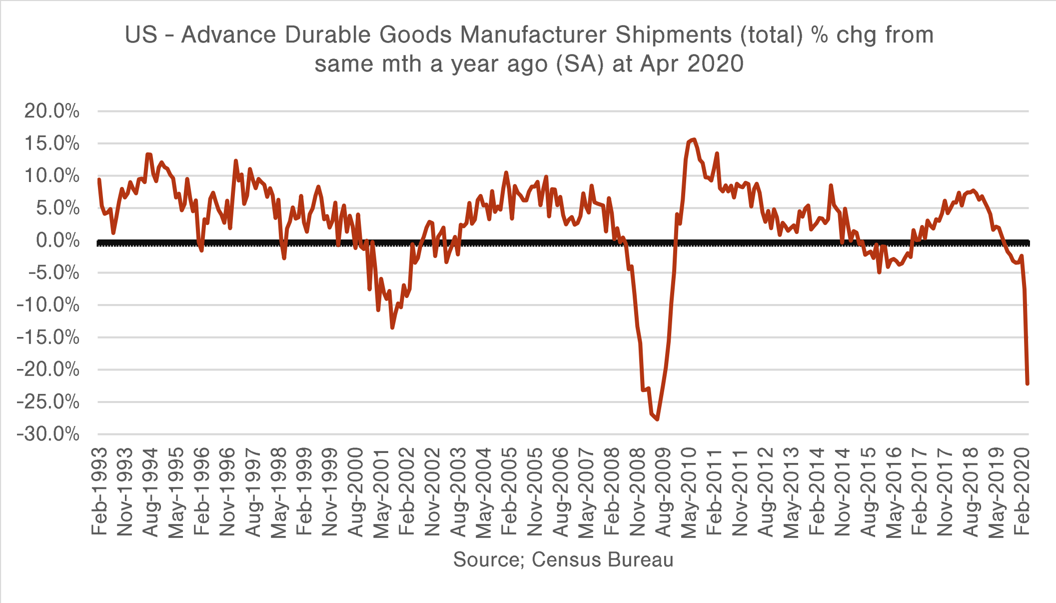


Non-defense aircraft shipments declined by -58% (-$6bn) in Apr versus Mar.

The total value of non-defense aircraft shipments in Apr fell to $4.4bn. This is now 70% below the peak in aircraft production shipments reached in Nov 2018.

Shipments of computers and electronic products was the only sector to record growth in the month; Apr +0.4% versus Mar -0.8%.

On an annual basis, durable goods shipments fell by -22% in Apr – certainly one of the steepest declines.



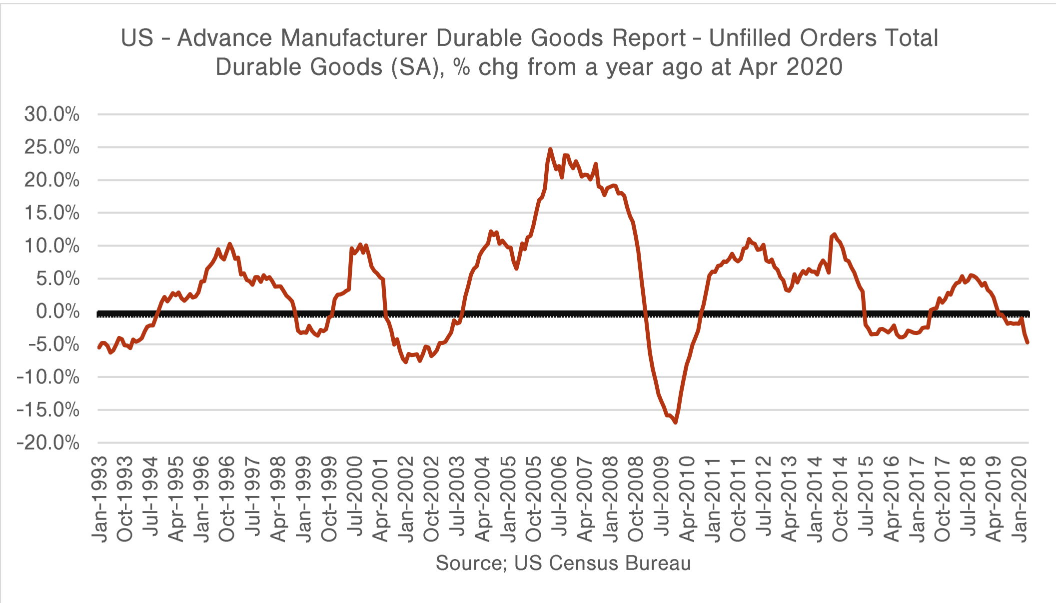
Excluding transportation equipment, shipments declined by -7.5% - and this is well above the declines recorded in the GFC and 2001.

<u>UNFILLED ORDERS</u>

<u>Unfilled orders – month change</u>; Apr -1.6% (-$17.5bn) versus Mar -2.1%

Overall unfilled orders declined at a slower pace in Apr. The bulk of the decline in unfilled orders was non-defense aircraft (-2.4% or -$13bn).

Unfilled orders declined at an accelerated annual pace in Apr of -4.7%. This is still well above the pace of decline across other periods of economic slowdown;



The value of non-defense aircraft orders makes up the bulk of the total value of unfilled orders (represents approx. 46% of the total value). The unfilled orders for non-defense aircraft unfilled orders is declining at -11.1% versus a year ago – this is significantly higher than all other durable goods categories – partly due to the decline/cancellation in orders.

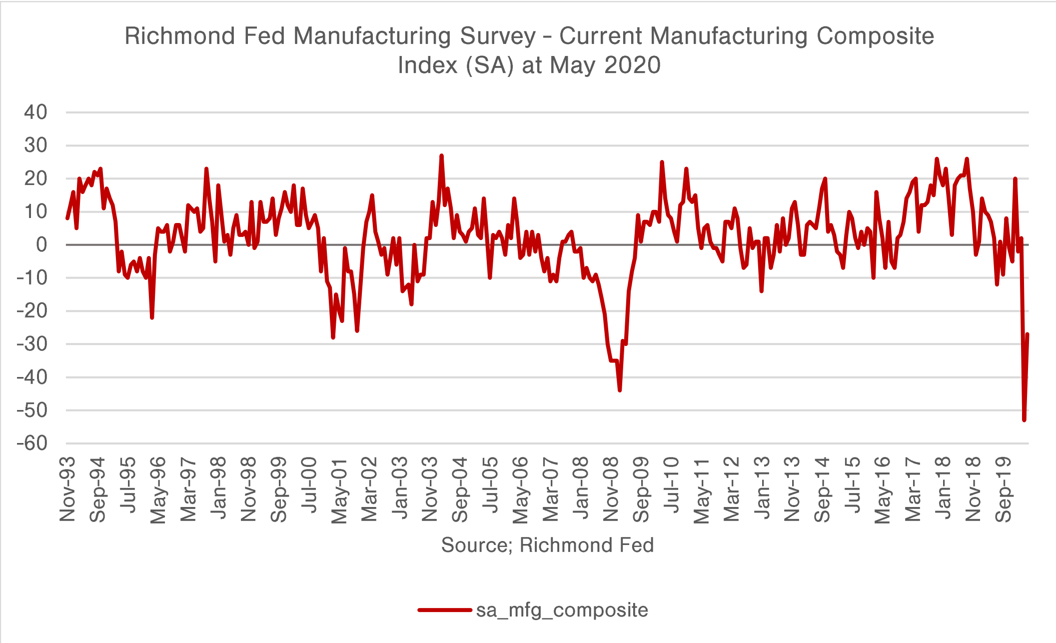
Excluding transportation equipment, durable goods unfilled orders declined slightly by -0.7% in Apr.

https://www.census.gov/manufacturing/m3/index.html

Richmond Fed Manufacturing Index (May)

Manufacturing activity continued to contract in May within the region but survey components were above their record low Apr readings, indicating that the pace of contraction has likely eased. The index of local business conditions remained firmly in contraction with expected conditions in six months only improving slightly.

Manufacturing Index; May -27 versus Apr -53



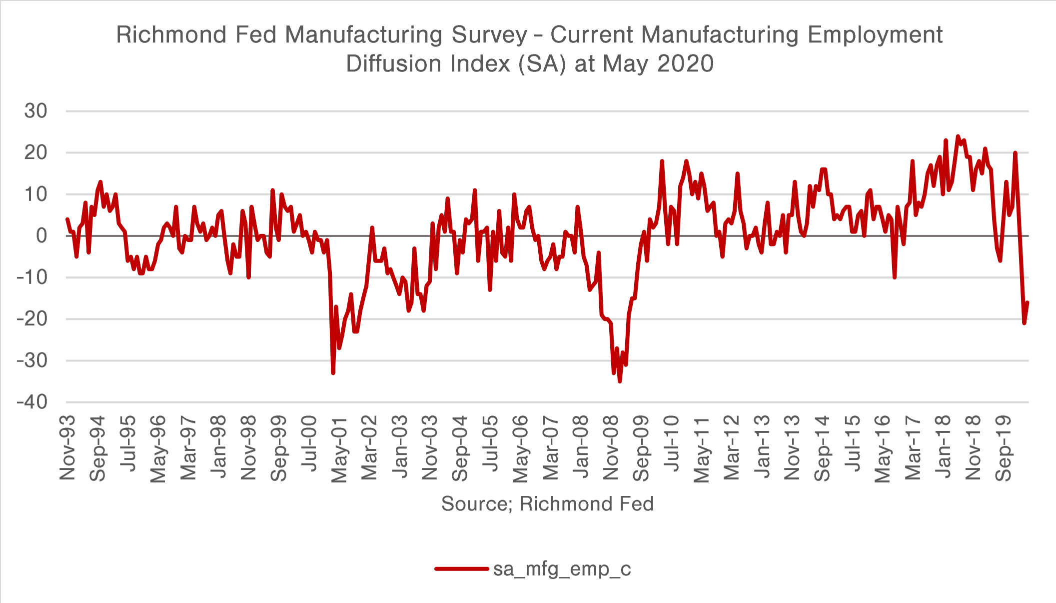
Both shipments and new orders declined further, but at a slower pace. The current level of both indexes still indicates a relatively sharp pace of contraction in May.

Order backlogs continued to decline, but at a somewhat slower pace.

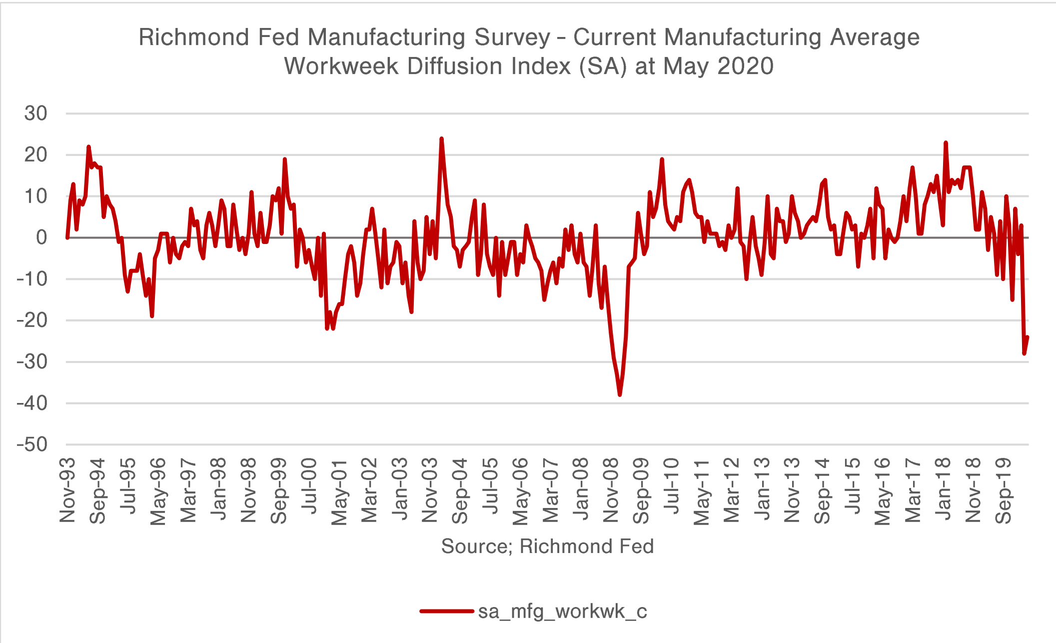
Capacity utilization also continued to decline. While there was a slightly slower pace of decline, the capacity utilization index still indicated that utilization continued to decline.

Finished goods and raw materials inventories both increased but at a slower pace.

Note that employment continued to decline. The pace of decline was only a few points lower than the decline in the month prior; May -16 versus Apr -20. At this stage, the pace of decline in employment is still well above that of the GFC (as one benchmark), but employment had declined from a much higher base this time;



The average work week was also little changed in May, with the index 'improving' from -28 in Apr to -24 in May. The scale of the decline in the average workweek was still above that of the GFC also;



The local business conditions index remained firmly in decline in May at -42, but at least above the extreme low recorded in Apr of -87. While current conditions remain negative/worsening, expected conditions in six-months at least started to improve. The expected conditions index increased to +4 in May – indicating marginal growth is expected from this current position.

https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2020/pdf/mfg_05_27_20.pdf

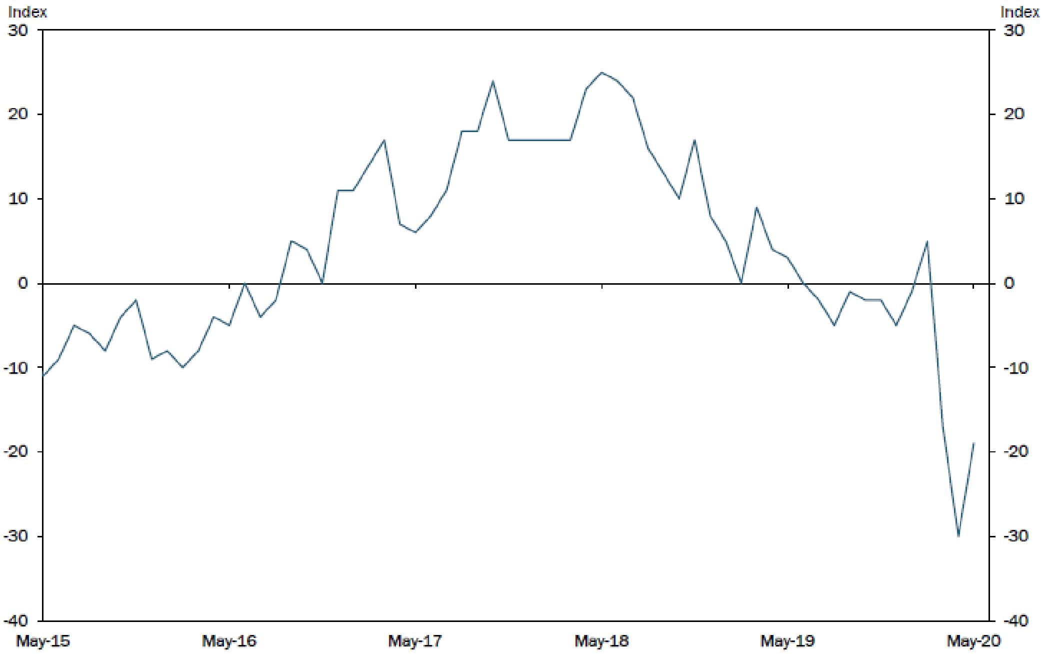
Kansas City Fed Manufacturing Activity Index (May)

As with other regional reports, activity continued to decline in May, but not as severely as in Apr. A slower pace of decline was recorded across all of the main sub-indexes this month.

> "The work is starting to return. We were hardest hit early when the lockdowns were put in place, nearly half of open industrial orders were cancelled or put on hold."

<u>Headline Composite Manufacturing Index;</u> May -19 versus Apr -30

Chart 1. Manufacturing Composite Index vs. a Month Ago



Production, volume of shipments and the volume of new orders all continued to decline this month, but the pace of that decline eased.

> "COVID has certainly hit our business but we are optimistic that it will still turn around before the end of the year. This will be a challenging summer for us… looking forward to the country opening up again."

> "PPP funds have allowed us to keep head count at current levels even though incoming work has dropped to minimal levels."

The backlog of orders continued to decline but at a slower pace. The level of the index at -32 remains extreme.

The number of employees continued to decline, but at a slower pace. The average workweek continued to decline at a slower pace. But the average workweek index at -20 highlighted that the contraction remained severe.

Supply issues remain as inventory of materials continued to decline. Inventory of finished goods also declined further but at a slower pace.

> "Uncoordinated reopening schedules will delay our distribution outlets from being fully functional."

Prices for raw materials and finished goods both continued to decline, but also at a slower pace.

The outlook remains concerning. The composite index for six months' time, still indicated that overall activity is expected to deteriorate. Similarly, expectations for production, shipments and new orders indicate only modest improvement from here.

> "We need more government support. Once we get beyond July, will banks be able to lend, and adjust terms/covenants to give additional breathing room? If not, we expect more trouble is ahead."

Probably the key driver of weaker expectations;

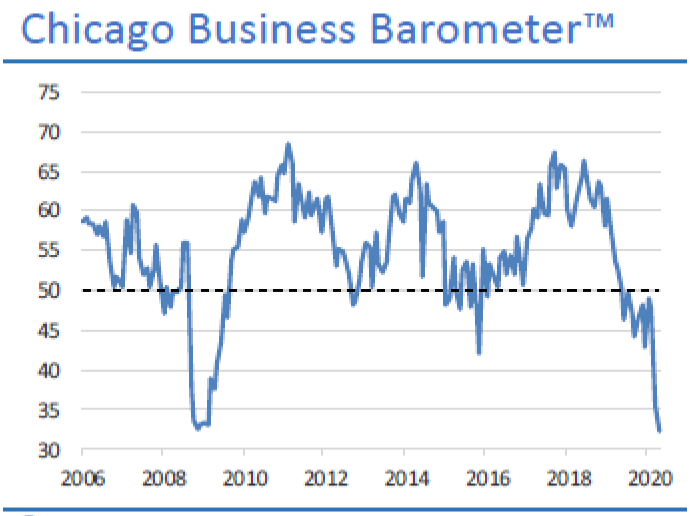
> "Low oil prices is a major problem."

https://www.kansascityfed.org/research/indicatorsdata/mfg

Chicago PMI (May)

The Chicago PMI declined at a faster pace in May with the headline index of activity falling to the lowest level since 1982.

Headline Chicago Business Barometer; May 32.3 versus Apr 35.4



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New orders declined at a faster pace than the month prior. Production also declined further by 6.3% in May after the already sharp fall in Apr. The production index remained at a 40-year low.

Order backlogs dropped another 28% and are now at the lowest level since 2009. This is the fifth month where backlogs have declined.

Inventories increased by 4.1%, now at an eleven-month high.

Employment experienced a rebound, but firms were mixed in their commentary. Some firms reduced workforces or salaries and others were looking for new hires.

https://www.ism-chicago.org/insidepages/reportsonbusiness/

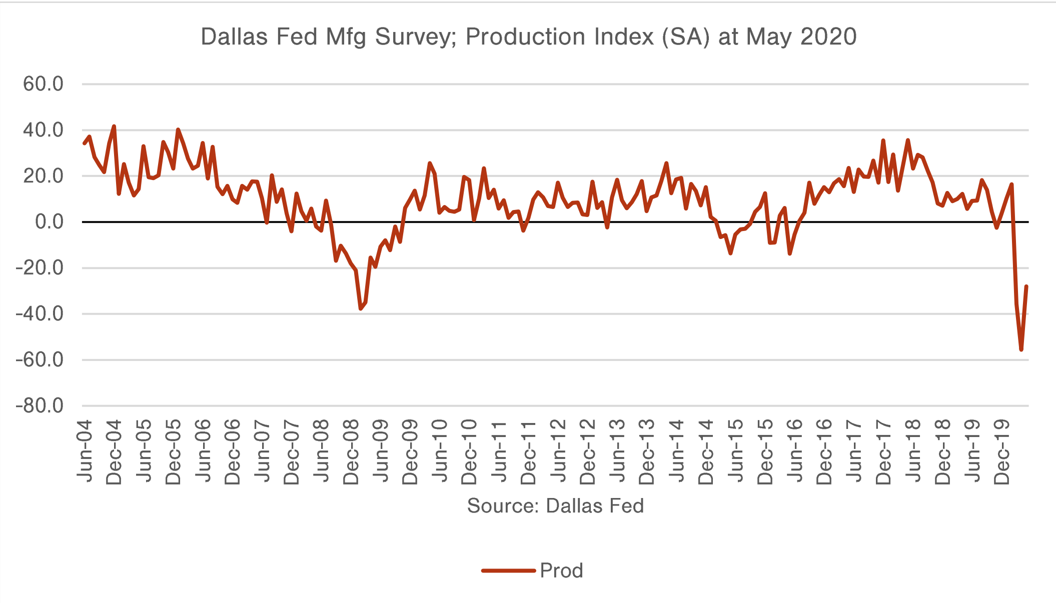
https://s3.amazonaws.com/images.chaptermanager.com/chapters/b742ccc3-ff70-8eca-4cf5-ab93a6c8ab97/files/mni-chicago-press-release-2020-05.pdf

Dallas Fed Manufacturing Business Index (May)

Similar to the prelim PMI and other regional surveys, manufacturing activity in Texas continued to contract in May, although that pace of decline eased. Overall, a large number firms reported a worsening in activity, but there was at least some improvement in the number of firms starting to report improvements. In most cases, there was little change in activity or outlook from the prior month. Underlying indicators such as hours worked, employment or prices received showed only smaller improvements at this stage.

Production Index; May -28 versus Apr -55.6

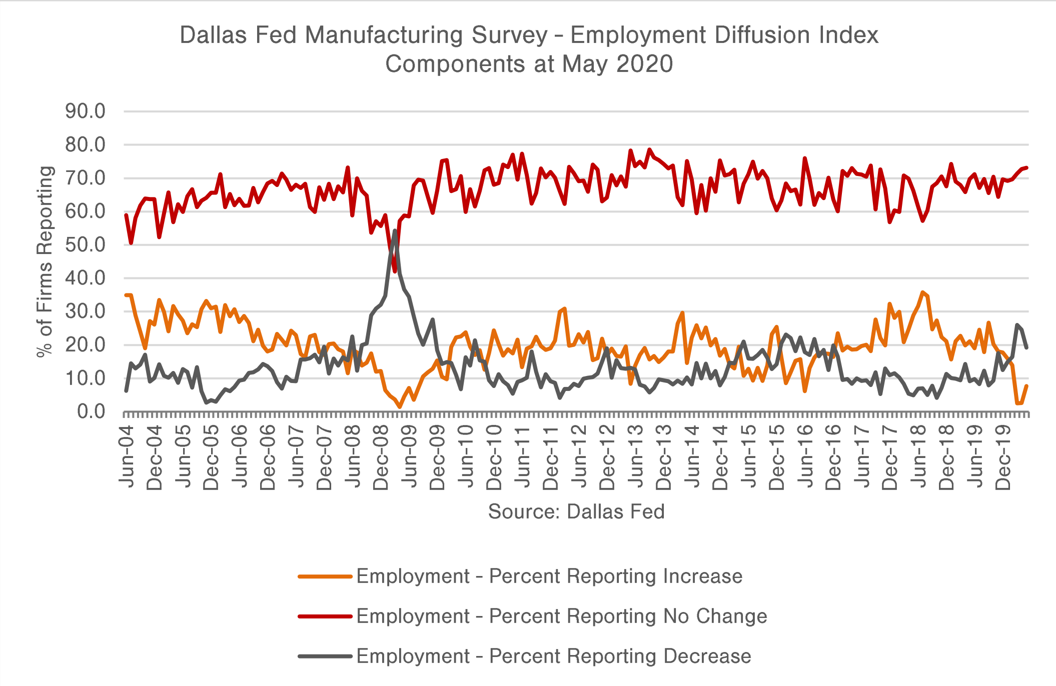
From an output perspective, this means that less firms were reporting a decline in output in May (45.5% of firms), but the number of firms reporting declines still outnumbered those reporting an increase. There was a corresponding increase in the proportion of firms that reported an increase in output from 9% in Apr to 17.5% of firms in May. But there was also an increase in firms reporting no change in output from severe declines reported last month – this increased from 26% in Apr to 36% of firms in May.



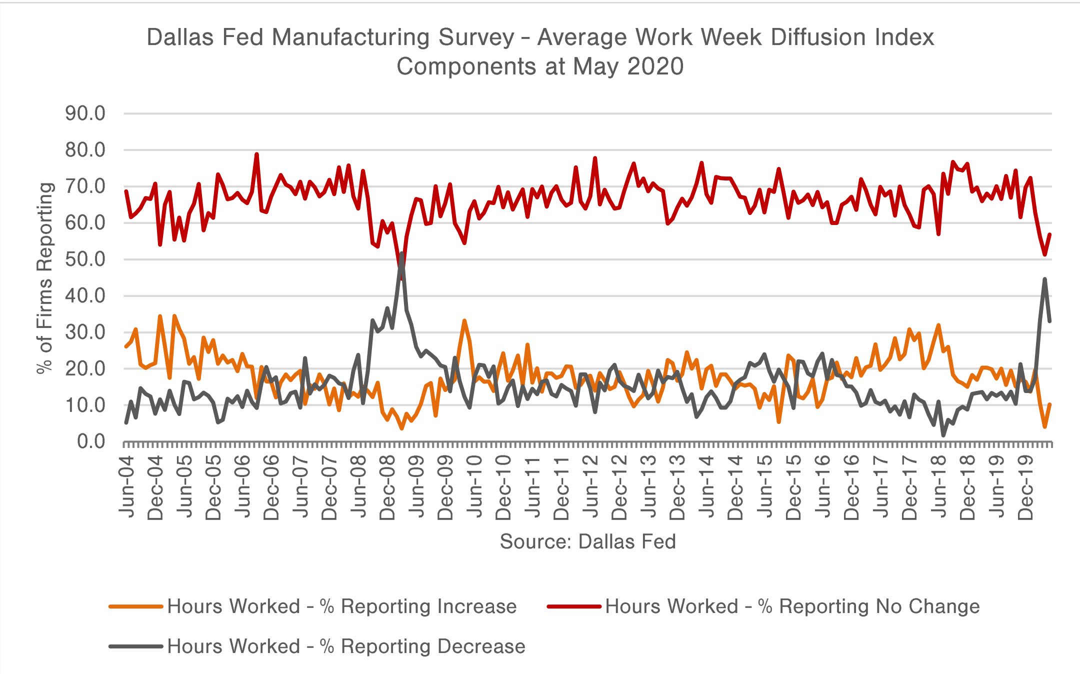
Similarly, new orders also declined at a less severe pace. But the proportion of firms reporting declining orders again this month (51.7%) still outnumbered the number of firms reporting increases (+21.1% of firms). Last month only 4.2% of firms reported an increase in new orders.

The growth rate of new orders and shipments also had a similar outcome – still declining, but less firms reporting declines versus the month prior.

Employment indices were only slightly improved. There was just a small decline in the number of firms reporting lower employment and a small corresponding increase in the number of firms reporting an increase in employment. From last month, we noted that employment appeared to be mostly 'on hold' – the vast majority of firms (+70%) have recorded no change in employment levels throughout this pandemic.



Instead employers had decreased hours worked. This month, there was a small decline in the number of firms reporting declining hours from 44.6% of firms in Apr to 33% of firms in May. But the 33% of firms still reducing the average workweek in May remains highly elevated compared to history;



There was only a small lift in the number of firms increasing the average workweek this month.

Margins continued to be squeezed for firms. Prices paid for raw materials shifted from decline in Apr to growth in May. But the prices received for raw materials continued to decline and only at a slightly slower pace than in Apr. Most firms (76%) reported no change in prices received. Only 2% of firms reported any increase in prices received.

The outlook remained negative. Most firms (46.2%) still reported a worsening outlook in May which was still lower than the 69% in Apr. But most of these firms shifted into 'no change' in their outlook. There was only a small increase in the number of firms reporting an improvement in their outlook; from 5.6% of firms in Apr to 11.6% of firms in May.

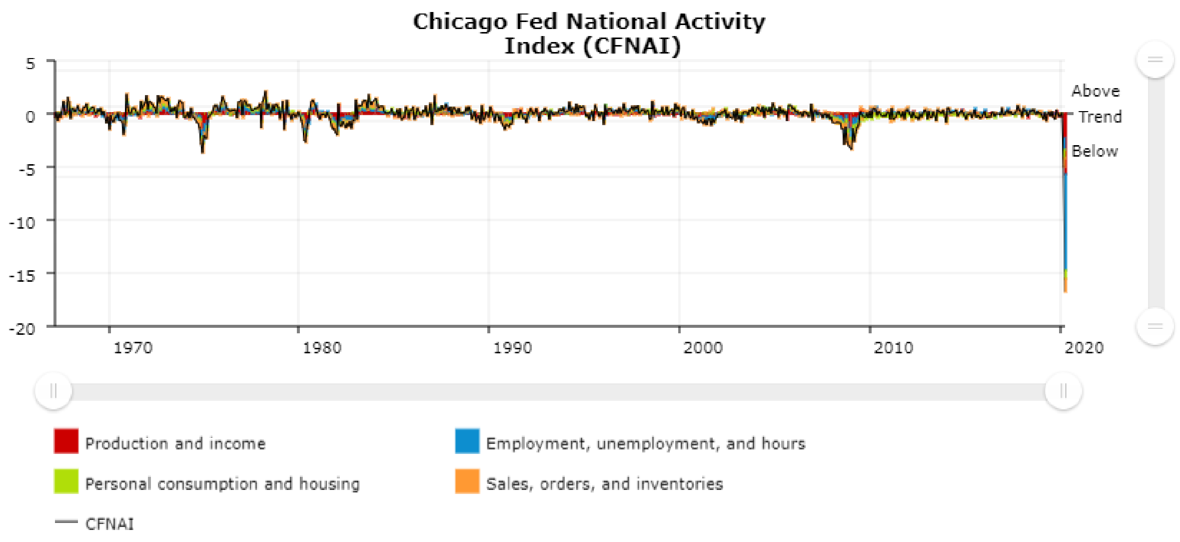
https://www.dallasfed.org/research/surveys/tmos/2020/2005.aspx

Chicago Fed National Activity Index (Apr)

The National Activity Index fell sharply in Apr, indicating that growth declined "substantially". This was on top of the negative result for Mar.

All four components of the index made negative contributions to the index this month. The chart below provides a historical perspective for the scale of the decline in activity in Apr, but also in Mar as well.

Chicago Fed National Activity Index; Apr -16.74 versus Mar -4.97



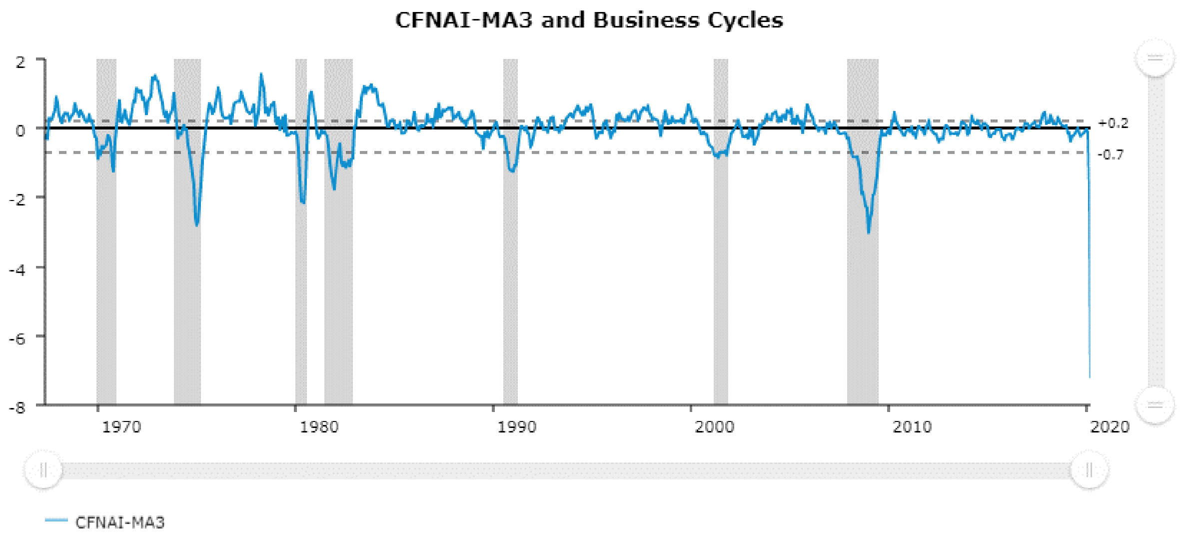
The largest contributor to the overall decline this month was from the employment, unemployment, and hours index; Apr -9.06 pts versus Mar-1.06 pts

Production and income also contributed further to the decline; Apr -5.63 pts versus Mar -2.31 pts

Personal consumption and housing were little changed; Apr -0.81 pts versus Mar -0.8 pts

Sales, orders, and inventories also made a slightly larger contribution to the decline in the month; Apr -1.24 pts versus Mar -0.81 pts

The three-month moving average fell to -7.22 in Apr. A three-month moving average of greater than -0.7 has historically been associated with an increasing likelihood of a recession. Again, the following chart provides the historical context for how severe the current contraction in activity is;



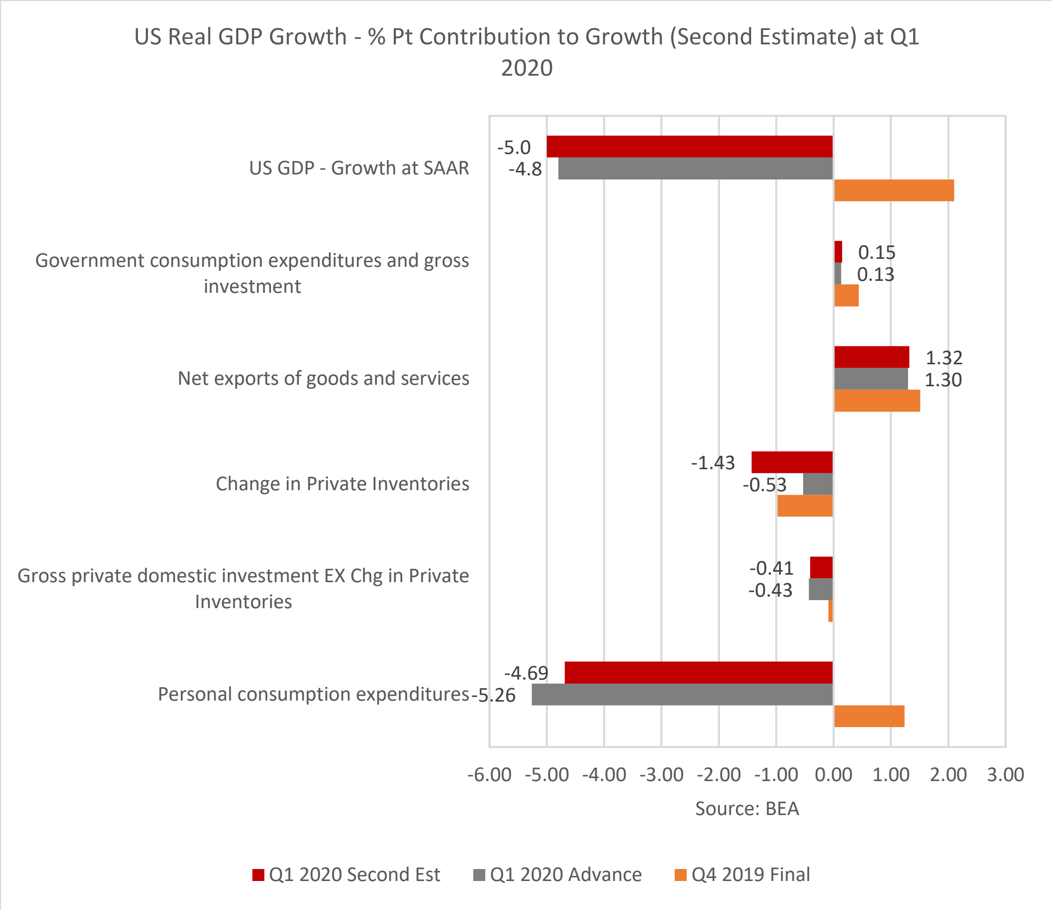
https://www.chicagofed.org/research/data/cfnai/current-data

GDP Second Estimate Q1 2020

In the second estimate, the change in US GDP was revised slightly lower from -4.7% to -5% in Q1 (SAAR).

The downward revision was mostly the result of a larger negative revision to the change in private inventories. The change in private inventories detracted -1.43% pts from headline growth (lower from -0.53%pts in the advance release).

This was offset by slight improvements or little change from personal consumption expenditures, private investment, net exports, and government expenditure.



https://www.bea.gov/data/gdp/gross-domestic-product

US Mortgage Applications wk ending 22 May

US mortgage applications increased last week, partly reversing the decline from the week prior.

Mortgage market composite index (loan application volume) wk ending 22 May; +2.7% versus the week prior.

Refi's decreased by 0.2% versus the week prior but remain +176% above the same week a year ago. Refi activity fell to 62% share of mortgage applications.

The purchase index, the measure of the number of loans finalised and a leading indicator of home sales) increased by 9% versus the week prior.

https://www.mba.org/2020-press-releases/may/mortgage-applications-increase-in-latest-mba-weekly-survey-x264194

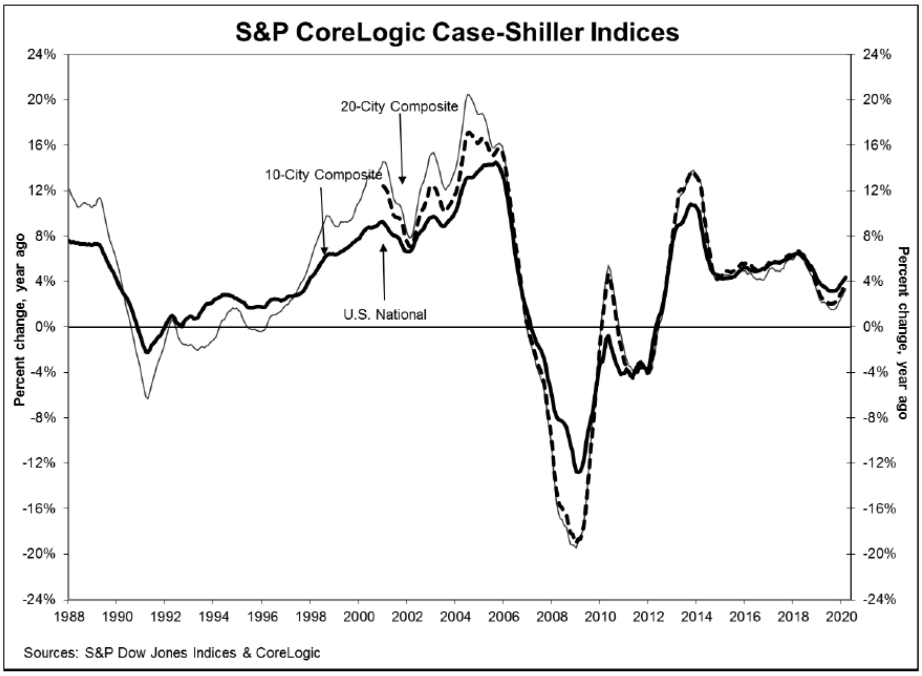
S&P CaseShiller House Price Index (Mar)

In the first month of the implementation of social distancing restrictions, house prices continued to increase. This data reflects transactions that closed in Mar, so may not yet reflect the impact of restrictions.

National Composite Index of House Prices – annual change; Mar 4.4% versus Feb +4.2%

The 10-City Composite Index – annual change; Mar +3.4% versus Feb 3%

The 20-City Composite Index – annual change; Mar +3.9% versus Feb +3.5%



https://us.spindices.com/index-family/sp-corelogic-case-shiller/sp-corelogic-case-shiller-composite

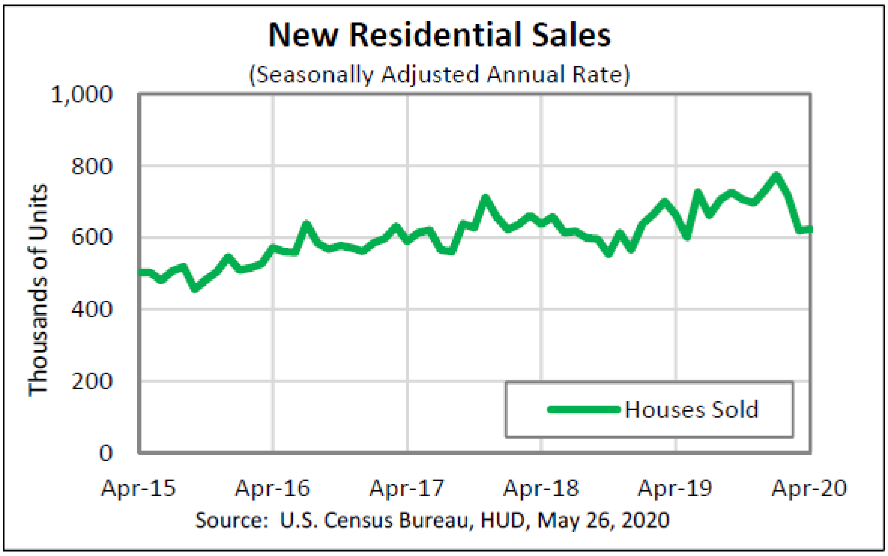
New Home Sales (Apr)

This month, there was little change in the estimate of new home sales in Apr. Across the National and regional estimates though, the 90% confidence interval for the estimates include zero – meaning that sales could have increased or decreased.

The trend takes approx. 4 months to establish.

National New Home Sales - SAAR basis by month; Apr 623k versus Mar 619k sales

This is a +0.6% increase from the pace in the month prior with a +/- 14.9% pts interval, meaning that sales could have increased or decreased in the month.



https://www.census.gov/construction/nrs/pdf/newressales.pdf

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Europe

Germany Q1 GDP (Detailed)

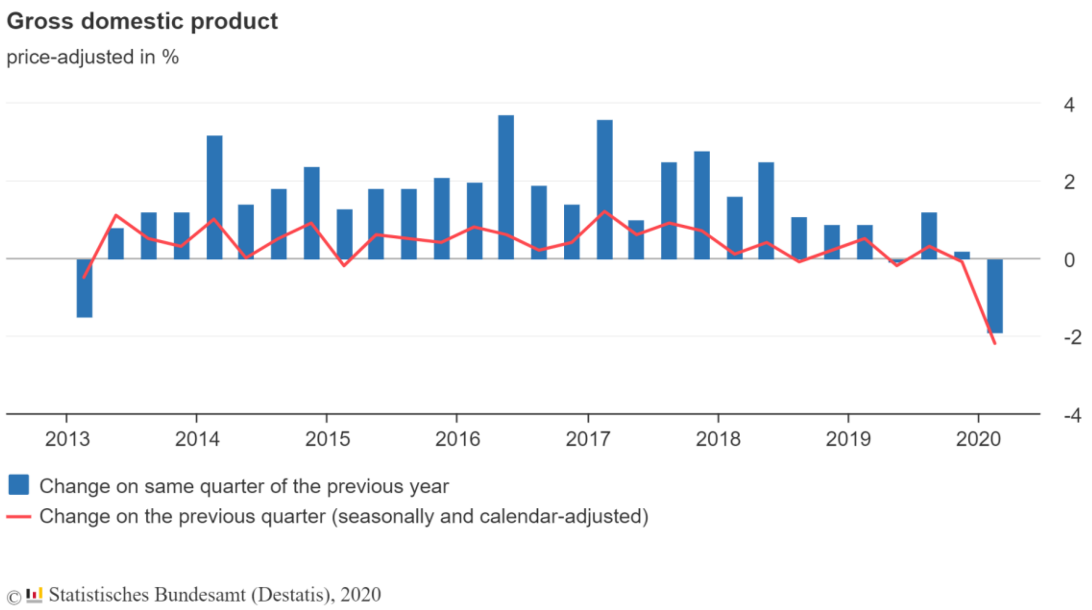
The latest estimate for GDP confirmed the Q1 decline in GDP of -2.2%. Most of the larger negative impact was recorded in Mar;

> Although the spread of the novel coronavirus did not have a major effect on the economic performance in January and February, the impact of the pandemic was quite serious even for the 1st quarter of 2020.

But the German economy was already weakening going into Q1. The Q4 2019 real GDP change was revised to -0.1%.

Real GDP – quarter change; Q1 2020 -2.2% versus Q4 2019 -0.1%

The annual decline in GDP of -1.9% was also confirmed in this release;



Expenditure View of GDP Performance

The largest contributors to the decline in GDP for Q1 were;

Household final consumption – which declined by -3.2% versus the quarter prior. The decline in consumption made the single largest contribution to the headline decline in GDP, detracting -1.7% pts.

Gross capital formation - continued to grow at a total level by +1.1% in the quarter, and contributing only +0.2% pts to headline GDP. Much stronger growth in construction of +4.1% offset an accelerated decline in capital formation in machinery and equipment of -6.9%. This was also confirmed by recent industrial production data.

Change in inventories – contributed +0.3% pts to headline GDP change.

Net exports – made a larger negative contribution to headlien GDP in Q1 detracting -0.8% pts in Q1 versus -0.4% pts in Q4 2019. This was the result of an accelerated decline in exports of -3.1% in Q1 (versus -0.6% in Q4) and an accelerated decline in imports of -1.6% (versus +0.1% in Q4).

https://www.destatis.de/EN/Press/2020/05/PE20_180_811.html

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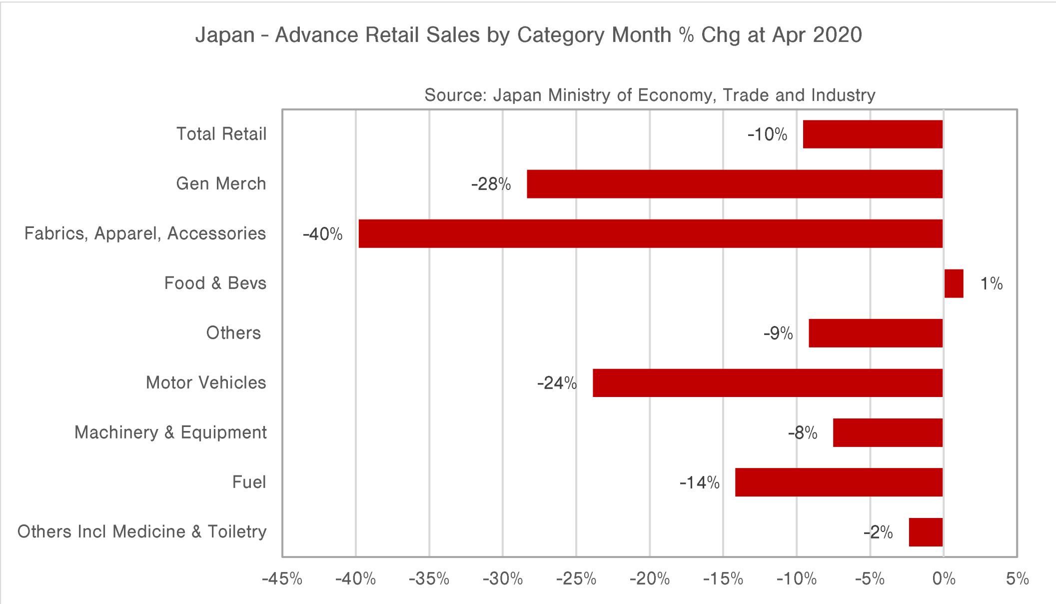
Japan

Retail Trade Advance (Apr)

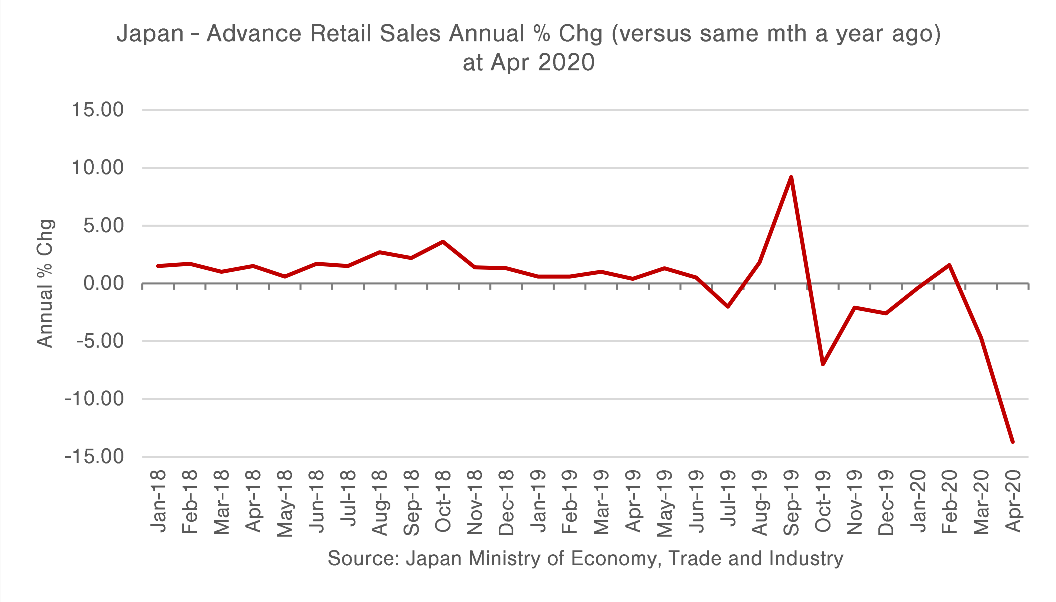
Retail sales in Japan suffered another large decline in Apr – this time due to Covid-19 restrictions. Most categories recorded sharp declines in sales for the month. The exception was the increase in food and beverage sales.

The annual pace of sales declined sharply in Apr after barely rebounding from the sales tax increase in Oct 2019.

Advance Retail Sales (val) – month change; Apr -9.6% versus Mar -4.6%



On an annual basis, retail sales declined by -13.7% versus the same month a year ago;



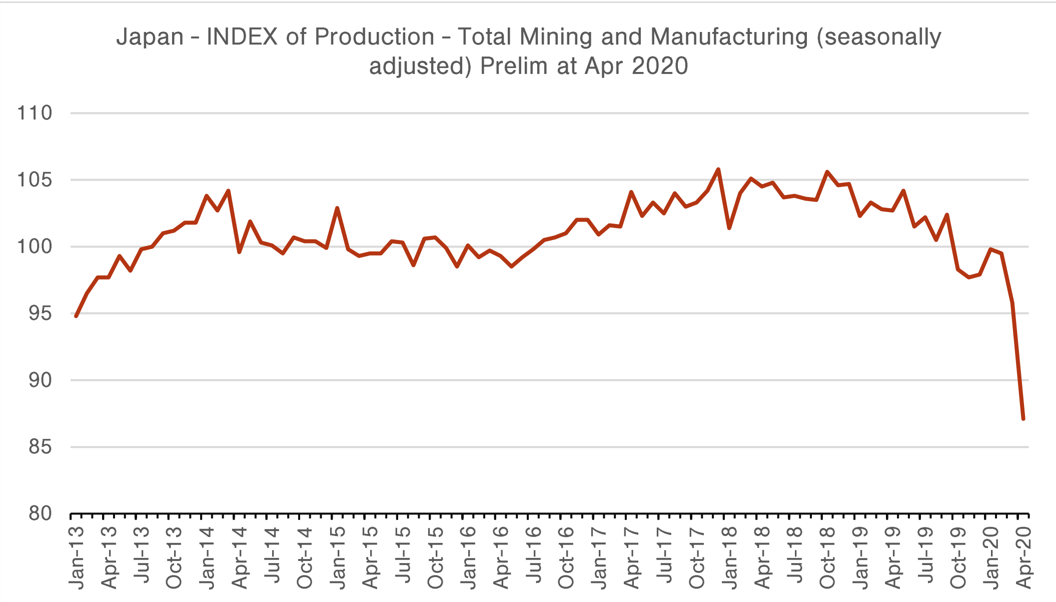
https://www.meti.go.jp/english/statistics/tyo/syoudou/index.html

Industrial Production Prelim (Apr)

The official Japanese industrial production data confirmed the scale of the decline in manufacturing activity in Apr as telegraphed by the weaker PMI's. The declines in production and shipments have been led mostly by larger falls in transport equipment manufacturing.

<u>Total Industrial Production – month change</u>; Apr -9.1% versus Mar -3.7%

The index of production activity has fallen below levels reached in 2013.



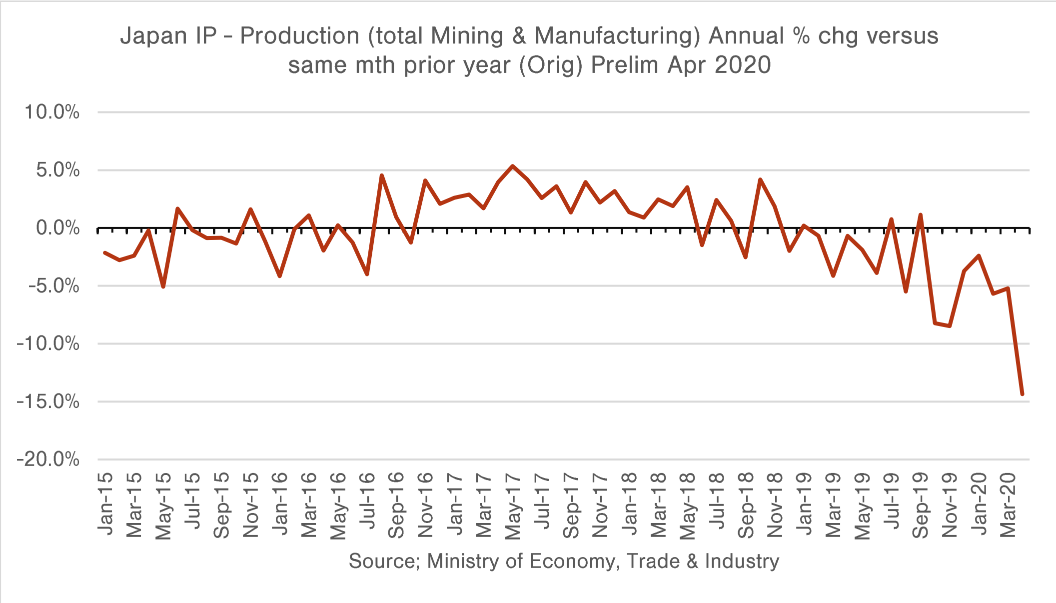
The steep decline in production was led mostly by transport equipment. Some sectors recorded steep declines in production, but not all areas fared poorly.

Transport equipment is the largest weight in the production index and production declined by 31.7% in the month. Within that, passenger car production declined by -40.8% in Apr. This weakness was also reflected in the decline in exports for the month.

The other sector where production declined at a faster pace than the total this month was iron and steel production, which was down -14.3%.

Production of machinery actually increased by +2.5% in the month – led mostly by semi-conductor and flat panel manufacturing equipment (+31.5%).

On an annual basis, production declined at an accelerated pace of -14.4% in Apr;



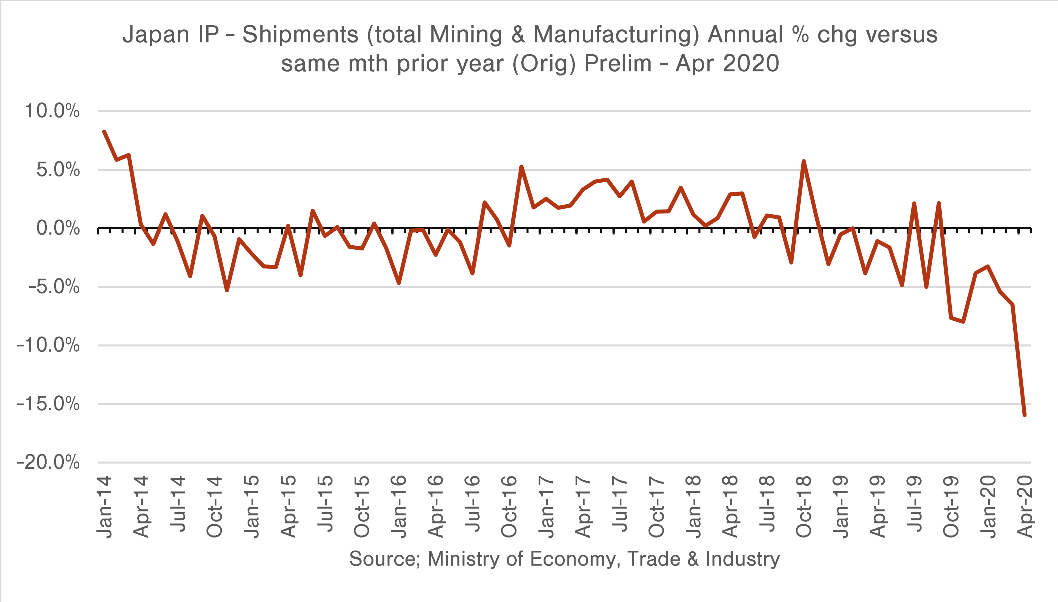
The worst performing category was the largest weight item in the index – transport equipment. Within that, motor vehicle production fell by 41% versus the same month a year ago.

<u>Shipments – month change;</u> Apr -8.8% versus Mar -5.8%

Again, not all sectors recorded declines in shipments this month. Shipments of production machinery increased by 4% and most other sectors declined slower than the headline -8.8% decline.

The main driver of the decline in shipments this month was transport equipment (-30%) and it is the largest weight in the index. Within that sector, shipments of motor vehicles declined by 33% in Apr.

On an annual basis, shipments declined by 15.9% versus the same month a year ago;



<u>Inventory – month change</u>; Apr -0.3% versus Mar +1.9%

Despite the fall in production and shipments, inventory of finished goods still declined in the month.

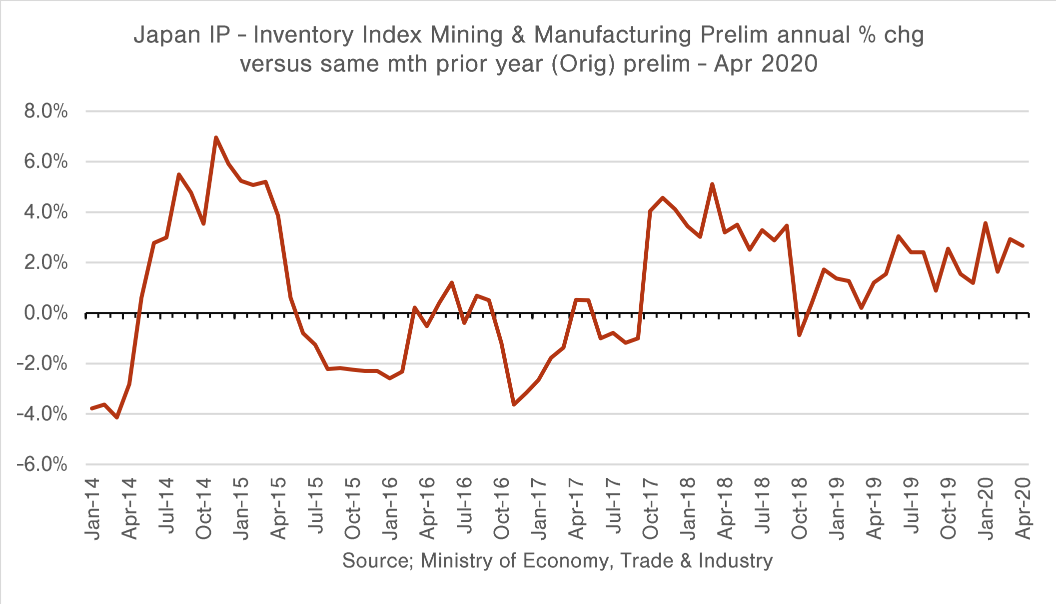
The largest sector weight in the inventory index is iron, steel, and non-ferrous metals – and inventory of finished goods declined by -5.7% in the month – likely influencing the sharp falls in production and shipments.

Inventory also declined across fabricated metals and production machinery.

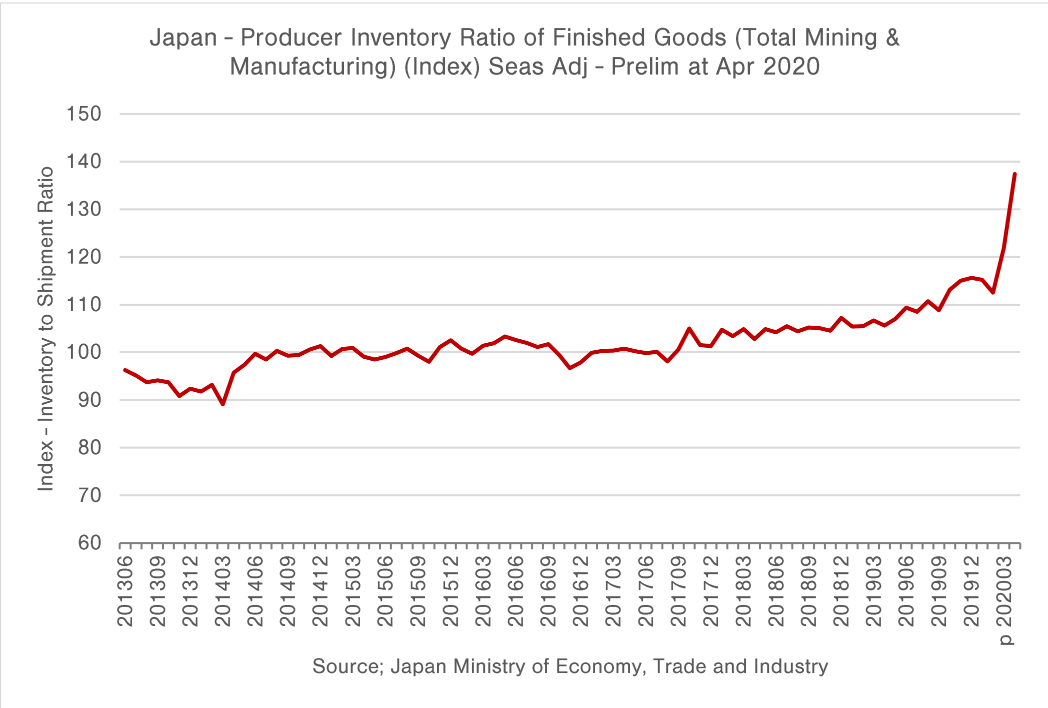
There were increases in inventory across transport equipment +8.3% - with motor vehicle inventory increasing by +8.5%.

Other sectors where inventory increased were; general purpose and business-oriented machinery, electronic parts and devices and electrical machinery.

On an annual basis, the value of inventory in Apr versus the same month a year ago is only +2.7%. This is still below recent levels of inventory growth;



Given the fall in shipments, the producers inventory to shipments ratio significantly increased this month. The index increased by 12.7% in the month;



https://www.meti.go.jp/english/statistics/tyo/iip/index.html

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Australia

Construction Work Done Q1

The real value of total construction work done continued to decline in Q1. The pace of decline slowed in Q1 due to a smaller decline in private sector construction work.

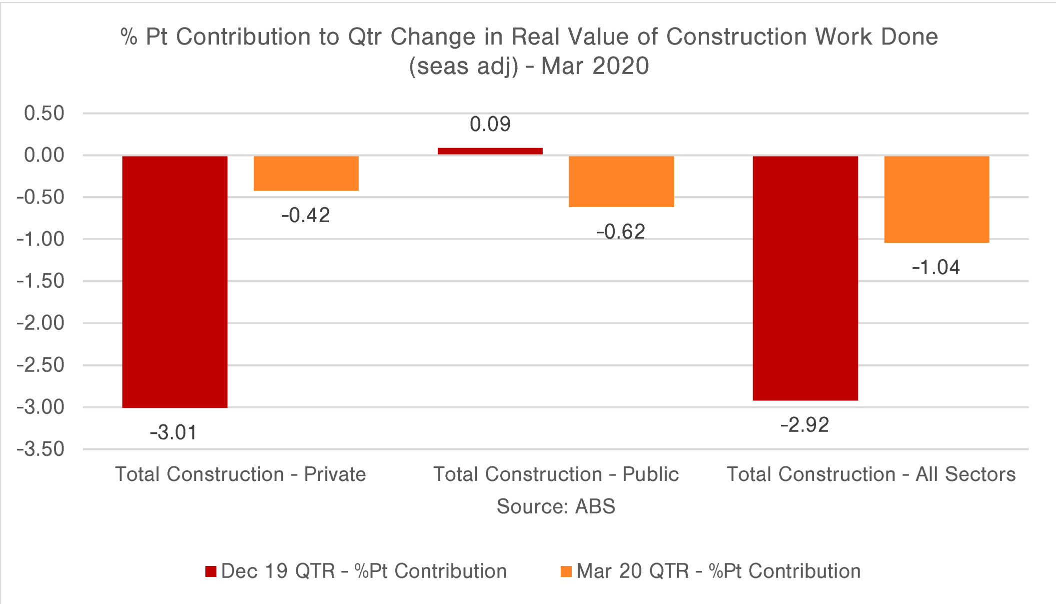
Private sector residential building continued to decline (slower), non-residential building was flat and private sector engineering increased slightly in the latest quarter after a larger decline in the prior quarter.

This helped to offset the decline in the real value of public sector construction work done in the quarter. This was mostly due to the fall in public engineering works.

The annual pace of decline in overall construction work done remained around -6.5%.

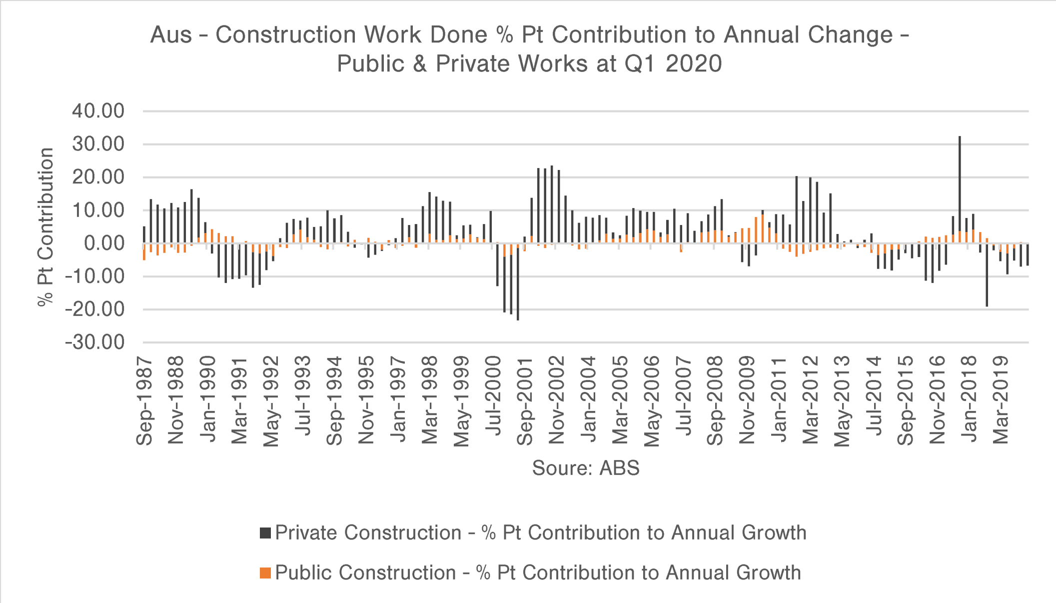
Construction work done – quarter change; Q1 Mar -1% versus Q4 Dec -2.8%

This quarter, private sector construction work done declined at a slower pace, while public sector works shifted into decline.



On an annual basis, construction work has continued to decline at a constant pace this quarter, falling by -6.5% versus the same quarter a year ago.

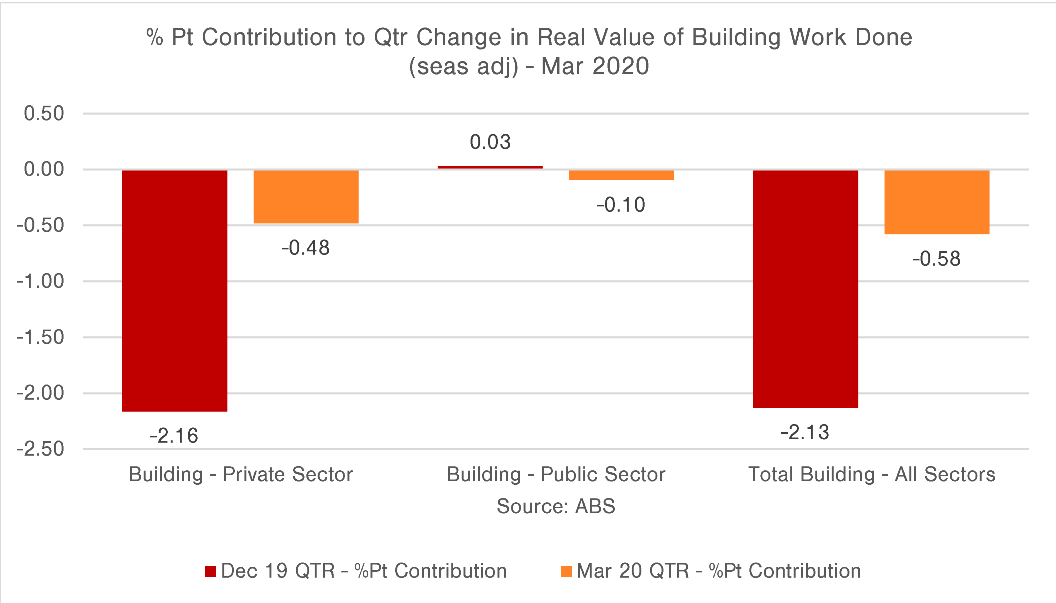
Construction work done has declined on an annual basis over the last seven quarters, led mostly by falling private sector construction. Public sector activity has also been weak;



There are two main areas of construction work done – building (including residential and non-residential construction) and engineering construction.

<u>Building work done – qtr change</u>; Q1 Mar -1% versus Q4 Dec -3.6%

Private sector building work declined at a slower pace in Q1, while there was little change in public sector works.



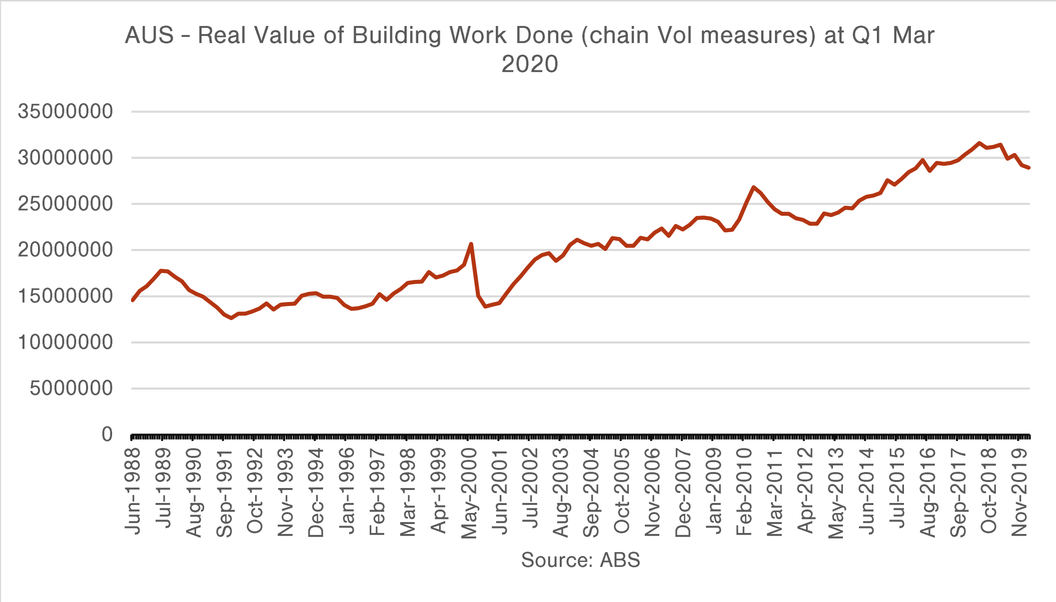
Building work includes both residential (approx. 60% of building work) and non-residential work.

Total residential building construction decreased in Q1 by -1.6%. New housing construction only declined by -0.3% in Q1 (after declining by -4.3% in Q4 2019). The decline in 'other residential' construction remained steep, falling by -4.5% in Q1 but still slower than the -6.5%

in Q4 2019. Total residential building construction is -12.5% below the same quarter a year ago.

Total non-residential building work was little changed in Q1 falling by -0.02%. Non-residential building is only -0.3% below the same quarter a year ago.

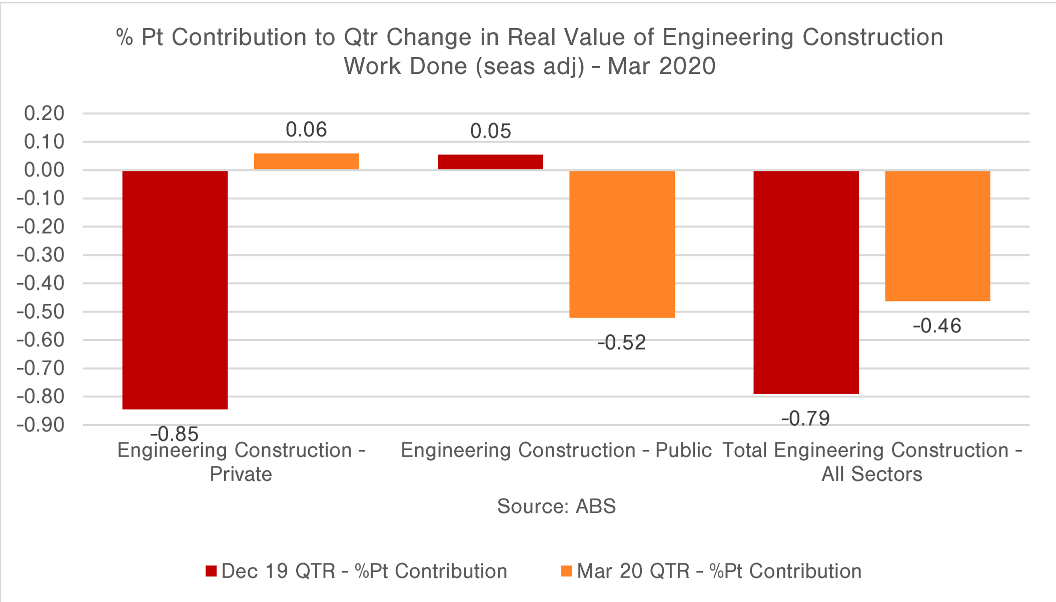
The value of total building work (public plus private) is only -0.1% below the recent peak in activity. Residential building peaked back in the Jun 2018 qtr and growth in non-residential building has helped to offset this decline;



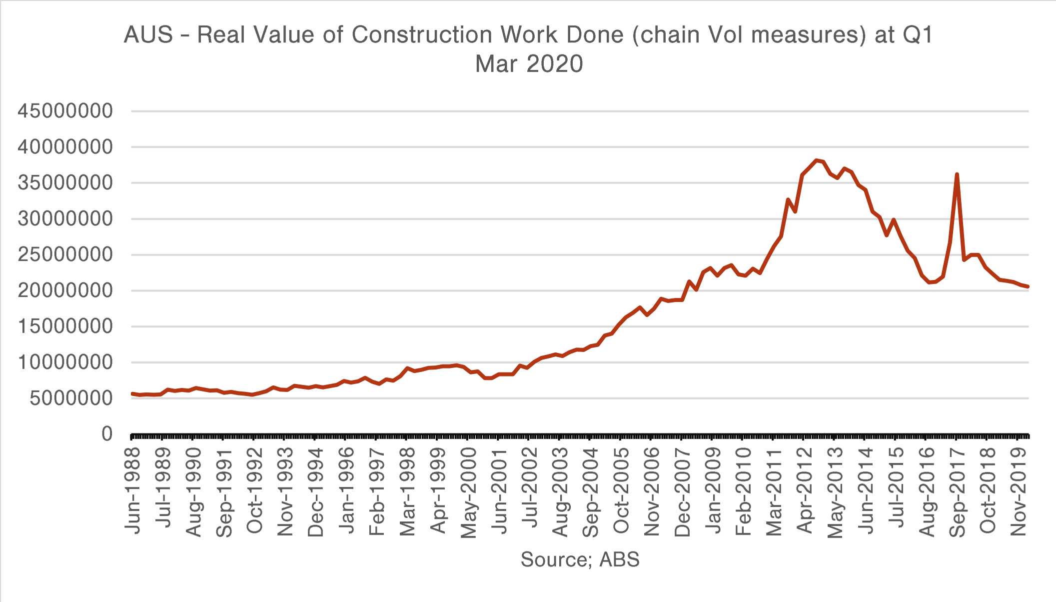
The second major area of total construction is engineering construction;

<u>Engineering construction work done – quarter change</u>; Q1 Mar -1.1% versus Q4 Dec -1.9%

The decline in the latest quarter was led by the fall in public sector engineering works. Private sector engineering work was little changed in Q1 after a larger fall in Q4 2019;



Over a longer time period, it's obvious that engineering work is well below its mining boom peak – for both private and public sector works.



https://www.abs.gov.au/ausstats/abs@.nsf/mf/8755.0?OpenDocument

Private Sector Capex (Q1)

Private sector capex fell again in Q1. Increases in capex across mining and manufacturing were offset by an accelerated decline in capex across selected other industries (mostly services).

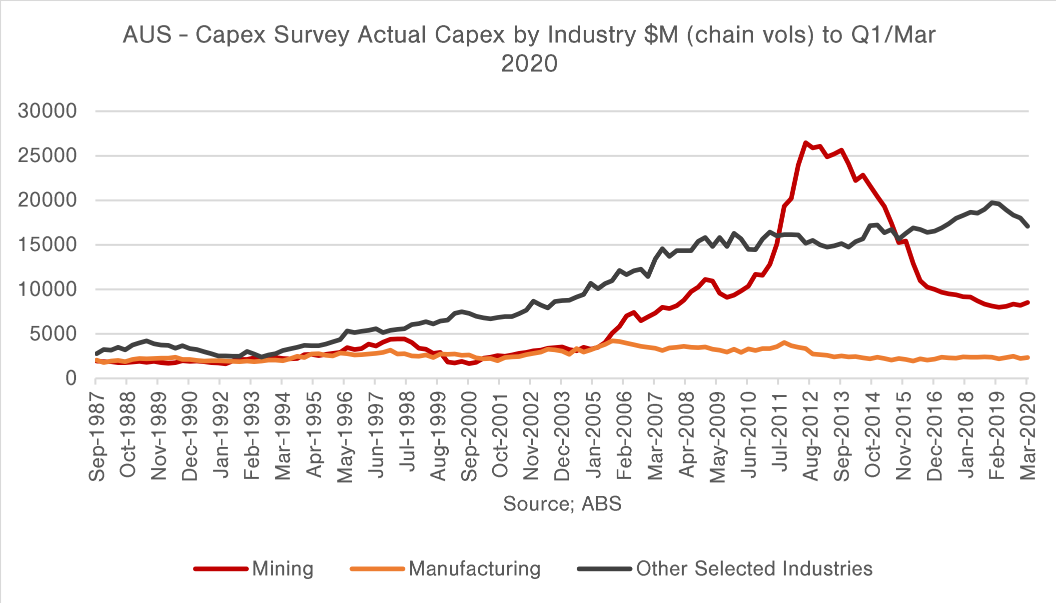
The annual pace of decline accelerated across the survey.

Capex – Qtr change; Q1 Mar -1.6% versus Q4 Dec -2.6%

Mining capex in the quarter increased by 4.2% and manufacturing capex increased by 5.7%. This was more than offset by a 5.2% decline in capex across other selected industries.

Since the fall in mining capex after the mining investment boom, other selected industries (mostly services) has become the largest area of capex.

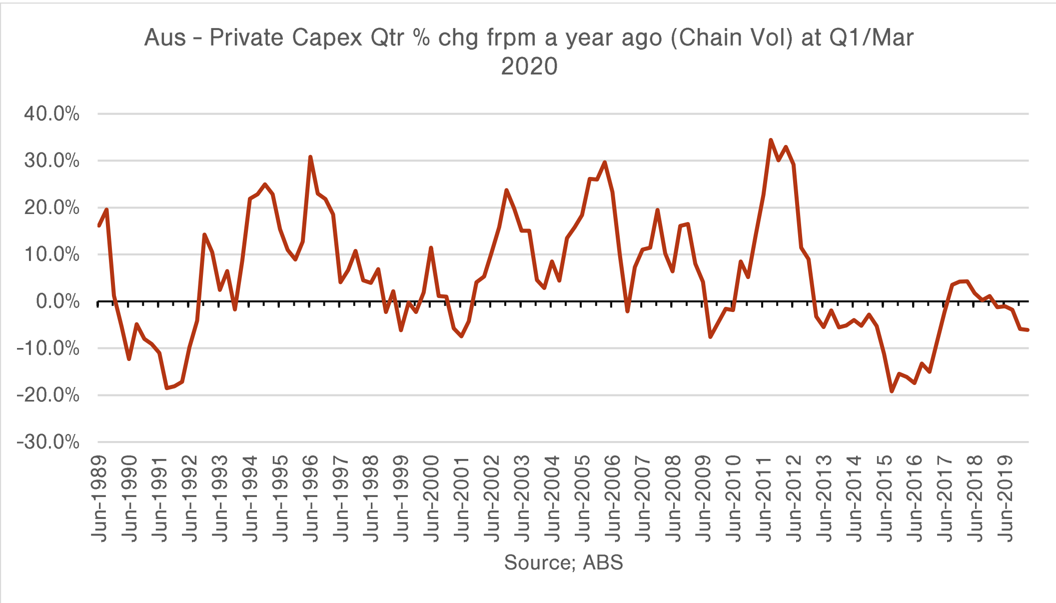
Capex across other selected industries already peaked back in early 2019;



<u>Capex – annual change</u>; Q1 2020 -6.1% versus Q4 2019 -5.9%

Similar to the quarterly result, the accelerated decline has been led by other selected industries.

Capex growth has been slowing in Aus since early 2018 and declining on an annual basis for the last five quarters;



Capex for other selected industries is now -12.8% below the same quarter a year ago. This has more than offset the growth across mining (+7%) and manufacturing (+7.2%) capex (versus the same quarter a year ago).

https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5625.0Main+Features1Mar%202020?OpenDocument

Private Sector Credit (Apr)

The credit and lending statistics for Apr provide an interesting perspective on lending activity for the month. Total outstanding private sector credit growth slowed to 0% in the month after growing by +1.1% in Mar (which is a notably high rate of growth).

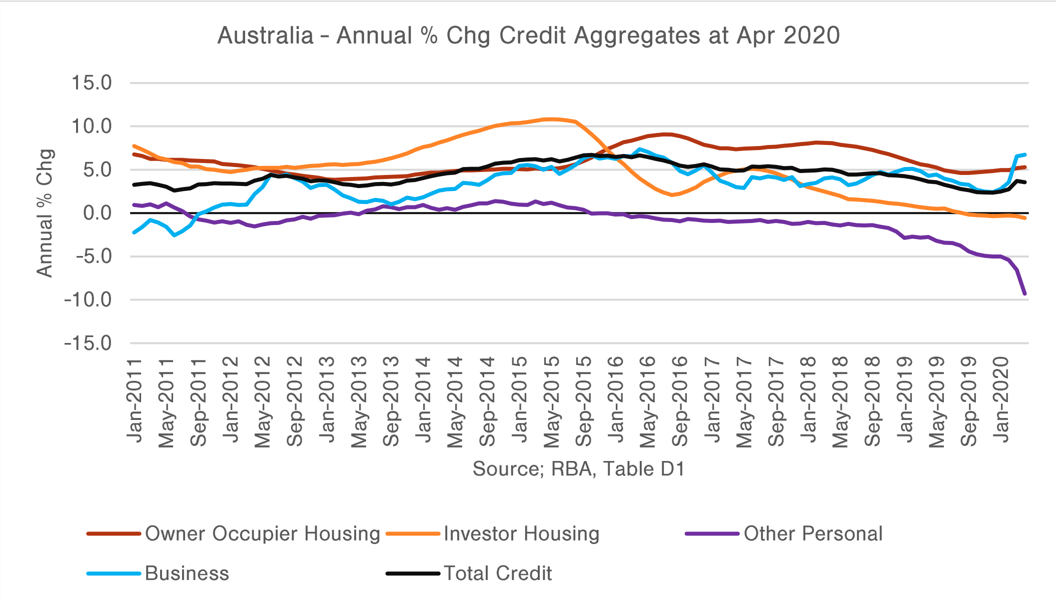
This month, growth in business credit slowed notably after a large increase in Mar (likely to due to business accessing credit lines). Investor housing credit and personal credit both declined at an accelerated pace versus Mar. The pace of growth in owner occupier housing credit continued to grow at a constant pace – despite the stay at home orders in place during the month - could be a lagged result, but owner occupier credit growth appears surprisingly resilient.

<ins>Total Private sector credit – annual growth</ins>; Apr +3.6% versus Mar +3.7%

On an annual basis - total outstanding business credit increased at a slightly faster pace of +6.7%, led by the large increase in Mar month.

Total outstanding housing credit increased at the same annual pace in Apr as in Mar of +3.1%. This was led by owner occupier credit growing at a slightly faster pace of +5.3%, while investor housing credit continued to decline at a faster pace of -0.6%.

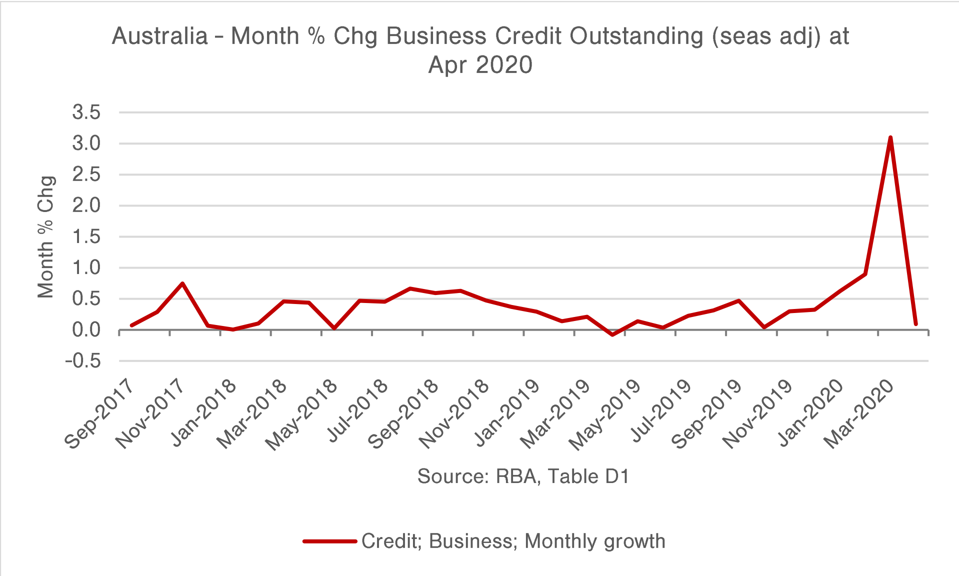
Other personal credit outstanding, declined at a much faster annual pace of -9.3% in Apr.



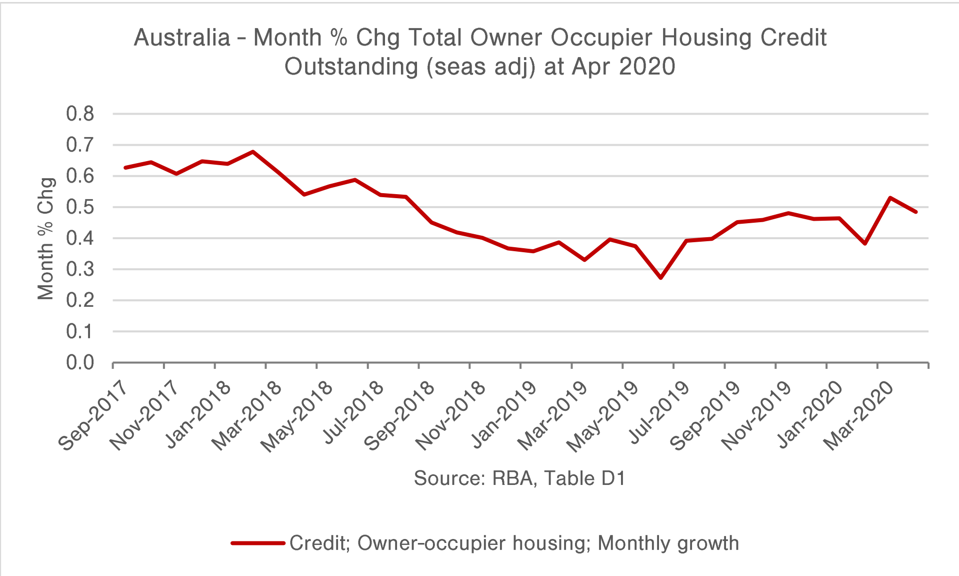
The underlying shifts in the monthly statistics are interesting.

In the month, total outstanding private sector credit growth slowed to 0% after a notable increase of +1.1% in Mar. The Apr result was led mostly by slower growth in outstanding business credit.

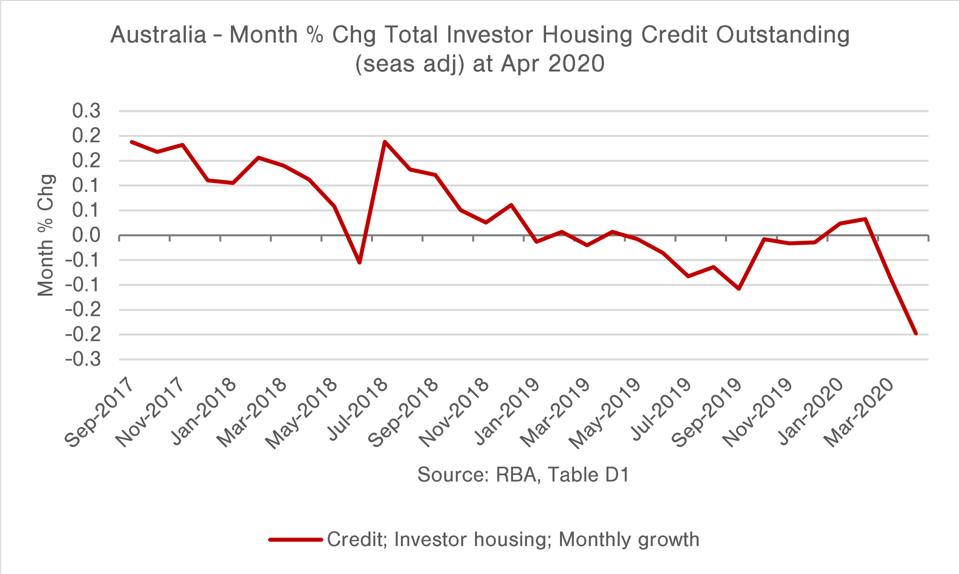
Business credit growth slowed to +0.1% after increasing by +3.1% in Mar. Business has likely drawn down on credit lines over the last few months, especially in Mar, to help bridge the stay at home orders.



Outstanding housing credit growth hasn't declined in the month as much as expected, given the stay at home orders. Owner occupier housing credit is still growing at +0.5% month on month, still rebounding from the mid-2019 lows.



But outstanding investor housing credit has continued to decline and this accelerated in Apr to -0.2% versus the month prior.



https://www.rba.gov.au/statistics/frequency/fin-agg/2020/fin-agg-0420.html

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Trade

US-China Trade Talks

Tensions between the two countries continue to simmer amid accusations and posturing regarding China's role in the spread of the Covid-19 virus. The delicate trade truce between the two countries remains at risk as both sides threaten renewed trade restrictions.

Late last week, US President Trump announced that steps would commence to revoke the favoured trade status of Hong Kong. Markets were expecting more dramatic measures in the announcement.

> President Trump on Friday announced no specific action as a result of plans to strip Hong Kong of its special status as semiautonomous from Beijing, so little may change in the immediate term for the internationalized Chinese city.
>
> The president on Friday said China's decision to impose a national security law was "absolutely smothering Hong Kong freedoms" and made it impossible for the U.S. to continue treating the city with a special status. https://www.wsj.com/articles/u-s-china-disputes-growing-harder-to-solve-11590963070?mod=hp_lead_pos6

Stage two of trade negotiations were planned to follow on from last years' agreement – but there has been no further progress. Reconfirming what a 'win' in the negotiations with China looks like – a statement of the key negotiating goals as outlined by the USTR from the initial USTR objectives (emphasis added);

> The meetings were held as part of the agreement reached by President Donald J. Trump and President Xi Jinping in Buenos Aires to engage in 90 days of negotiations **with a view to achieving needed structural changes in China with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft of trade secrets for commercial purposes, services, and agriculture**.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/statement-united-states-trade

US-Japan Trade Talks

The focus in early 2020 will be on phase two of the deal – originally planned to begin from April or May this year. There is no indication of timing for the start of phase two at this stage.

> After the deal enters into force, the countries have agreed to conclude consultations for further trade talks within four months. Then discussions between their lead negotiators, Foreign Minister Toshimitsu Motegi and U.S. Trade Representative Robert Lighthizer, will start again in earnest.
>
> The United States is seeking a full-fledged free trade agreement that covers areas including services and investment.

https://www.japantimes.co.jp/news/2019/12/04/business/economy-business/upper-house-approves-united-states-japan-trade-deal/#.Xe3HTegzaUk

The issue for phase two talks is auto tariffs;

> Japan has said it has received U.S. assurance that it would scrap tariffs on Japanese cars and car parts, and that the only remaining issue was the timing. But Washington has not confirmed that.
>
> https://www.reuters.com/article/us-usa-trade-japan/japan-lower-house-passes-u-s-trade-deal-auto-tariffs-still-in-question-idUSKBN1XT0IK

Details from the Congressional Research Service; https://crsreports.congress.gov/product/pdf/IF/IF11120#targetText=Japan's%20Diet%2C%20however%2C%20will%20have,effect%20on%20January%201%2C%202020.

The summary of US negotiating objectives for the US-Japan trade talks;

https://ustr.gov/sites/default/files/2018.12.21_Summary_of_U.S.-Japan_Negotiating_Objectives.pdf

US-Europe Trade Talks

There are several fronts to the US-EU trade discussions.

Airline Subsidies

The US has officially notified the WTO that it has complied with the dispute raised by the EU on US subsidies to Boeing. The US has now enacted the Senate Bill that eliminates the preferential tax treatment for aerospace manufacturing.

> The removal of the subsidy fully implements the WTO's recommendation to the United States, bringing an end to this long-running dispute. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/us-notifies-full-compliance-wto-aircraft-dispute

From 18 Oct, the US had implemented tariffs on some EU imports as a part of the WTO ruling on the Airbus case. This week, the USTR announced a further increase in the tariff rate in aircraft imported from the EU into the US from 10% to 15% - effected from 18 Mar 2020. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/february/ustr-revises-75-billion-award-implementation-against-eu-airbus-case

Trade Deal Negotiations

The key sticking point remains agriculture. The EC authorised negotiations to commence between the EU and the US – but excluding agriculture. Emphasis added;

> "Today's adoption of the EU negotiating directives gives a clear signal of the EU's commitment to a positive trade agenda with the US and the implementation of the strictly defined work programme agreed by Presidents

> Trump and Juncker on 25 July 2018. **But let me be clear: we will not speak about agriculture** or public procurement."

https://www.consilium.europa.eu/en/press/press-releases/2019/04/15/trade-with-the-united-states-council-authorises-negotiations-on-elimination-of-tariffs-for-industrial-goods-and-on-conformity-assessment/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Trade+with+the+United+States%3a+Council+authorises+negotiations+on+elimination+of+tariffs+for+industrial+goods+and+on+conformity+assessment

> ""I do not think we will reach an agreement if agriculture is not included," McKinney told reporters on a teleconference during his visit to Brussels, citing concerns raised by U.S. lawmakers and Trump." https://www.reuters.com/article/us-usa-trade-eu/no-u-s-eu-trade-deal-without-agriculture-u-s-official-idUSKCN1TS2SH

The threat of auto tariffs also remains an issue, despite the US missing the S.232 deadline of 14 Nov. https://www.cnbc.com/2019/11/08/trump-wont-impose-tariffs-on-european-cars-eu-juncker-says.html

Digital Services

> France on Monday agreed to suspend a 3% digital tax on U.S. tech companies in exchange for Washington holding off on a threat to impose tariffs of up to 100% on a $2.4 billion list of French imports, a French diplomatic source said. **https://www.reuters.com/article/us-usa-trade-deals/after-china-trade-deal-europe-and-uk-next-on-trumps-to-do-list-idUSKBN1ZL2TJ**

The USTR S.301 investigation into the digital services tax approved by the French government has been completed and released its report on 2 Dec 2019;

> "USTR's decision today sends a clear signal that the United States will take action against digital tax regimes that discriminate or otherwise impose undue burdens on U.S. companies," Ambassador Robert Lighthizer said. **"Indeed, USTR is exploring whether to open Section 301 investigations into the digital services taxes of Austria, Italy, and Turkey**. The USTR is focused on countering the growing protectionism of EU member states, which unfairly targets U.S. companies, whether through digital services taxes or other efforts that target leading U.S. digital services companies." https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/conclusion-ustr%E2%80%99s-investigation

The proposed action includes up to 100% duties on certain French products imported into the US. The USTR is now inviting comments on the proposed action at a public hearing in Washington on 6-8 Jan 2020. https://www.federalregister.gov/documents/2019/12/06/2019-26325/notice-of-determination-and-request-for-comments-concerning-action-pursuant-to-section-301-frances

and

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/public-hearing-proposed-action-frances-digital-services-tax-0

Background

The summary of US negotiating objectives for the US-EU trade talks have been published;

https://ustr.gov/sites/default/files/01.11.2019_Summary_of_U.S.-EU_Negotiating_Objectives.pdf

Section 232 – Car and Truck Imports

Back in May 2019, President Trump has agreed to delay the decision to impose tariffs on auto imports as a part of the s.232 investigation on car and truck imports on national security grounds. A Reuters article during the week reported that President Trump may no longer be able to impose tariffs under this S.232 investigation because of the missed announcement deadline. Source: https://www.reuters.com/article/us-usa-trade-autos/trump-can-no-longer-impose-section-232-auto-tariffs-after-missing-deadline-experts-idUSKBN1XT0TK

> The 1962 act is clear about the time limits that a president has for invoking tariffs to protect U.S. national security.

The article outlines other recent cases where the increase in tariffs have been challenged due to missed deadlines (Turkey and the increase in steel tariffs in 2018).

The article outlines the "escape hatch" for President Trump;

> A clause in the 1962 law may offer an escape hatch for Trump. If an agreement is not reached within 180 days or proves ineffective, "the President shall take such other actions as the President deems necessary to adjust the imports of such article so that such imports will not threaten to impair the national security." It adds that Trump would be required to publish these actions in the Federal Register, but does not specify a time frame.

For the moment, there have been no announcements made by the USTR or by the USTR on the Federal Register.

The threat of auto tariffs is likely to remain as negotiating leverage between the US and Japan and the EU. The S.232 report has not been made public, but President Trump's statement provided some insight as to how the Commerce Dept justified the 'national security' grounds. There are other avenues for how these tariffs may be implemented.

NAFTA/USMCA

The new USMCA will enter into force on 1 Jul 2020.

A quote from the release highlights further focus on manufacturing in the US, especially in the post-pandemic world;

> "The crisis and recovery from the Covid-19 pandemic demonstrates that now, more than ever, **the United States should strive to increase manufacturing capacity and investment in North America**. The USMCA's entry into force is a landmark achievement in that effort. Under President Trump's leadership, USTR will continue working to ensure a smooth implementation of the USMCA

> so that American workers and businesses can enjoy the benefits of the new agreement," said Ambassador Robert Lighthizer. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/april/usmca-enter-force-july-1-after-united-states-takes-final-procedural-steps-implementation

US-UK Trade Talks

There has been no further update on the first round of trade negotiations between the UK and the US at this stage. Trade negotiations commenced w/c 4 May and were expected to run in parallel with the EU Brexit/trade negotiations.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/statement-ustr-robert-lighthizer-launch-us-uk-trade-negotiations

The actual details of the negotiations are largely unknown and causing concern in the UK;

> "The precise details of any UK-US Free Trade Agreement are a matter for formal negotiations, and we would not seek to pre-empt these discussions.
>
> "The Government is clear that when negotiating FTAs we will continue to protect our right to regulate in the public interest where we deem fit." https://www.express.co.uk/news/world/1288548/uk-government-brexit-trade-deal-chlorinated-chicken-farmers-us-trade-liz-truss

The USTR has published the summary of specific negotiating objectives for the US-UK trade negotiations; https://ustr.gov/sites/default/files/Summary_of_U.S.-UK_Negotiating_Objectives.pdf

BREXIT

Negotiations are set to resume on 2 Jun ahead of the EU summit later in the month. Little progress has been made in previous rounds of talks;

> In a statement released on May 15, after the last round of meetings, Frost said the "major obstacle" in the negotiations at the moment is represented by "unbalanced proposals" that, according to Frost, would see the UK still "bind to EU law or standards" after Brexit - something which is "unprecedented in Free Trade Agreements", he added.
>
> The transition period is set to expire on December 31 this year, hence the UK and the EU need to reach an agreement by then or risk ending up in a "no-deal" scenario, which both sides repeatedly claimed they want to avoid. https://www.euronews.com/2020/05/31/they-ve-taken-three-steps-back-barnier-points-finger-at-uk-ahead-of-brexit-talks-resumpti

The deadline for extending the negotiations is approaching at the end of June 2020. The UK maintains that an extension will not be requested.

"Transition ends on 31 December this year," Frost said on Twitter last week. "We will not ask to extend it. If the EU asks, we will say no."

If the two sides can't reach a deal, the UK would default to trading on terms set by the World Trade Organisation, meaning the return of tariffs and quotas where there are none today.
https://www.straitstimes.com/world/europe/brexit-talks-resume-with-time-for-a-deal-running-out

Link to the EU draft is embedded in the release;
https://ec.europa.eu/commission/presscorner/detail/en/IP_20_447

The UK negotiating objectives;
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868874/The_Future_Relationship_with_the_EU.pdf

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